78-1168

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-

MONTE J. WALLACE AND NEIL W. WALLACE,
Petitioners,
v.

SECURITIES AND EXCHANGE COMMISSION, CONTINENTAL INVESTMENT CORPORATION, AND CREDITORS COMMITTEE OF CONTINENTAL INVESTMENT CORPORATION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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January 25, 1979

WILSON · EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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Monte J. Wallace and Neil W. Wallace petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix A) is reported at 586 F.2d 241. That opinion affirmed a decision of the United States District Court for the District of Massachusetts (Appendix B) which has not been reported. The District Court's decision had reversed an unreported decision of the Bankruptcy Court (Appendix C) denying transfer of this matter from Chapter XI of the Bankruptcy Act to Chapter X.

JURISDICTION

The judgment of the Court of Appeals (App. A at 17a) was entered on October 27, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Does the Bankruptcy Act delegate to the Securities and Exchange Commission the power to preclude confirmation of a negotiated plan of arrangement under Chapter XI which is found both to be fair and feasible and to serve the needs of the public creditors solely because the arrangement may significantly affect those public creditors?

STATUTORY PROVISIONS INVOLVED

Sections 141, 146, and 328 of the Bankruptcy Act, 11 U.S.C. §§ 541, 546, and 728, are set forth in Appendix D.

STATEMENT

Petitioners own or control sixty-five percent of the common stock of Continental Investment Corporation ("CIC"). On April 30, 1976, CIC filed a petition seeking an arrangement under Chapter XI of the Bankruptcy Act. On November 9, 1976, the Bankruptcy Court denied a motion by the Securities and Exchange Commission ("SEC") to transfer the proceeding to Chapter X, and on November 30, the Bankruptcy Court confirmed CIC's plan of arrangement under Chapter XI.[1] The needs of CIC's public debtholders were protected under

[1] CIC's petition is attached to the Bankruptcy Court's Order confirming CIC's Chapter XI plan of arrangement. That Order is reproduced as Appendix E.

the Chapter XI plan, as the Bankruptcy Court's opinion denying transfer reflects, by effective organization by major holders of the public debt, negotiation of the proposed plan of arrangement by experienced businessmen representing institutions holding a substantial portion of that debt, and agreement by all parties with an economic interest upon a plan of arrangement that includes provisions to control or replace management if the need to do so arises.

In addition, the Bankruptcy Court found that

> (i) the proposed plan of arrangement was feasible, fair, and in the best interests of the creditors, and that there was no evidence that more favorable terms for the public debtholders could have been negotiated;
>
> (ii) there was no demonstration that new management was needed;
>
> (iii) there was no showing of a need, in light of an investigation already performed by a committee of creditors, for any further investigation of the acts of the company or of its management; and
>
> (iv) the debtor's shareholders and debtholders overwhelmingly approved the proposed Chapter XI plan of arrangement after full disclosure of all material facts.

On March 31, 1978, the District Court set aside the confirmation and ordered the proceeding transferred to Chapter X, and on October 27, 1978, the Court of Appeals affirmed the District Court's decision. The District Court and the Court of Appeals did not set aside any of these findings by Bankruptcy Court. Rather, the basis for their decisions holding CIC ineligible for Chapter XI relief was their belief that "major reorganizations of publicly held debt where the investors are many and widespread must proceed in Chapter X." (App. A at 16a, 20.)

A. Facts

CIC is a diversified financial services company operating entirely through subsidiary corporations. Its capital structure is relatively simple. It has senior debt, approximately $61,000,000 as of June 30, 1975, held by 16 banks. (App. A at 3a.) It has outstanding subordinated debenture indebtedness, in the aggregate principal amount of approximately $38,500,000 as of May 1, 1975, which is held by approximately 1,600 holders of record. Finally, CIC has outstanding approximately 13,000,000 shares of common stock held by approximately 4,100 holders of record. (App. C at 2c.)

In 1974, CIC defaulted on its bank debt and its subordinated debentures. CIC thereupon entered into extensive negotiations with its lending banks, a Debentureholders Protective Committee formed by institutional holders of about 10 percent of the outstanding debentures, and two pension funds that together held an additional 16 percent of the outstanding debentures. (App. A at 3a.) At the same time, counsel for the Debentureholders Protective Committee conducted an independent investigation into the affairs of CIC. (App. C at 3c.)

CIC's creditors deliberately avoided Chapter X. They feared that the cumbersome, lengthy, and expensive procedures of Chapter X would (i) unduly disrupt CIC's business, (ii) risk the loss of a valuable tax loss carryforward, and (iii) risk the cancellation of valuable investment advisory contracts held by CIC's investment advisor subsidiary Waddell & Reed, a loss that would also disrupt the business of other profitable CIC subsidiaries that use Waddell and Reed salesmen to sell insurance and interests in oil and gas partnerships. (App. C at 4c.) On July 29, 1975, CIC, its bank lenders and the representatives of the debentureholders reached agreement in principle on a proposed restructuring of CIC based on an arrangement under Chapter XI. (App. A at 3a.)

CIC's Chapter XI plan of rehabilitation was designed, as the Court of Appeals later observed,

> "to greatly reduce CIC's annual debt service obligations. Combined with steps already taken by management to divest CIC of marginal and unprofitable subsidiaries and to reduce costs, the parties hope to return CIC to profitable operation. Indeed CIC has been able to produce positive operating revenue in 1976 and 1977." (*Id.* at 4a.)

Under the Chapter XI plan the unsecured debentureholders are to receive subordinated debentures and two classes of preferred stock.[2] Outside the Chapter XI plan, but in conjunction with it, CIC's bank debt was reduced by $34,000,000 through foreclosure of a security interest in stock of a former CIC subsidiary on April 27, 1976. (App. C at 3c.) Contingent on confirmation of the Chapter XI plan of arrangement, the banks are to receive notes and stock in exchange for the remaining secured indebtedness.[3]

The proposed restructuring contemplated solicitation of debentureholder consents and shareholder approval. Accordingly, representatives of CIC and the debenture-

---

[2] The debentureholders are to receive (i) $3,500,000 in Subordinated Interest-Inclusive Debentures due 1984; (ii) 1,125,000 shares of Junior Preferred Stock with a liquidation preference/redemption price of $20 per share and attached warrants to purchase 1,780,000 shares of common stock of CIC; and (iii) 800,000 shares of Convertible Preferred Stock with a liquidation preference/redemption price of $20 per share, convertible into 4,000,000 shares of common stock of CIC. App. A at 3a-4a.

[3] The banks are to receive Senior Term Notes in the principal amount of $20,000,000, along with 350,000 shares of Senior Preferred Stock with a liquidation preference/redemption price of $20 per share and attached warrants to purchase 600,000 shares of CIC common stock. *Id.* at 3a.

holders met with the SEC in August and September of 1975 and presented the proposed plan. On September 29, 1975, CIC filed with the SEC, in preliminary form, a combined Registration Statement under the Securities Act of 1933 and Proxy Statement under the Securities Exchange Act of 1934. Discussions between CIC and the SEC staff concerning the content of the combined filing continued for approximately six months. Although the proposed plan clearly contemplated proceedings under Chapter XI,[4] at no time during this period did the Commission advise CIC of any intention to file a motion to transfer to Chapter X if CIC attempted to have the proposed plan confirmed under Chapter XI. (*Id.* at 5c.)

When the SEC cleared the Registration Statement, in March 1976, CIC promptly solicited consents from its debentureholders and proxies from its shareholders. The plan was approved by approximately 89 percent of all shares outstanding, and consents were initially received from holders of approximately 82 percent in number and in amount of CIC's outstanding subordinated debentures. By the time of the District Court's decision, approximately 90 percent of the debentureholders had consented. (App. A at 3a.)

As the Court of Appeals concluded, each group agreed to "sacrifices" in order to secure the Chapter XI plan. (*Id.* at 11a.) The secured bank debtholders agreed to forego interest claims, to take stock of a CIC subsidiary in partial satisfaction of CIC's debt, and to accept notes and preferred stock in satisfaction of the remainder. The debentureholders agreed to forego interest claims and a claim to a substantial portion of the equity interest in CIC. The common stockholders agreed to give the debentureholders the power to elect a majority of the

[4] *E.g.*, Continental Investment Corporation Prospectus, March 19, 1976, at ii. The Prospectus is included in the Consolidated Record Appendix on Appeal (filed in the Court of Appeals) at pp. 137-394.

board of directors, and subjected their equity share in the company to a substantial (approximately one-third) dilution.[5] Considering these and other details of the plan the Bankruptcy Court found that "[t]he terms of the securities to be issued in exchange for the publicly held debt appear to be fair to the holders thereof." (App. C at 6c.) By their votes and consents, as well as by their position on appeal, the securityholders appear to have agreed.

B. Litigation

On April 30, 1976, CIC filed its Chapter XI petition in the U.S. District Court for the District of Massachusetts. The District Court had jurisdiction under 28 U.S.C. § 1334. The petition was filed in Chapter XI under authority of Bankruptcy Act § 322, 11 U.S.C. § 722. The petition proposed the arrangement that had already been approved by shareholder vote and consented to by the debentureholders.

On June 18, 1976, the SEC moved under Section 328 of the Bankruptcy Act, 11 U.S.C. § 728, to transfer the case to Chapter X. No party in interest joined the SEC's motion. The Bankruptcy Court, to which the case had been assigned, and which had already held a hearing on confirmation, held an additional hearing on the motion to transfer on August 3, 1976, and admitted various affidavits and documentary materials into evidence. On November 9, 1976, the Bankruptcy Court denied the SEC's motion. (App. C.) Three weeks later it confirmed CIC's Chapter XI plan. (App. E.)

In its decision denying the SEC's transfer motion, the Bankruptcy Court found as a fact that the Chapter XI plan was "feasible and in the best interests

[5] *See id.* at 4a. Six members of the eleven member board of directors are to be elected by the holders of the convertible preferred stock (the debentureholders), and four by the holders of the common stock. The eleventh director is to be selected by the initial ten.

of the creditors"; that the terms of the exchange of securities for the subordinated debentures were "fair"; that there was no evidence that "terms more favorable to the public debtholders could have been negotiated"; and that the Chapter XI plan eliminated any need "to take any action affecting the rights of secured creditors or holders of certificates of beneficial interest" except implementation of the refinancing agreement between CIC and its bank creditors, which it recognized would "require no further action by the Court." (App. C at 6c, 7c (emphasis deleted).) The Bankruptcy Court also determined that there was "no evidence of wrongdoing on the part of management of the debtor"; that in light of the investigation already conducted there was no need of any further investigation into the propriety of any past acts of CIC or its mangement by an independent trustee; and that there was insufficient evidence "to warrant a finding that new management of the debtor is needed." (*Id.* at 7c.) Judging from these facts and an assessment of the "needs to be served" in the bankruptcy proceeding, *see General Stores Corp.* v. *Shlensky*, 350 U.S. 462 (1956), the Bankruptcy Court found that there was insufficient evidence "to warrant a finding that relief under Chapter XI of the Bankruptcy Act would not be adequate." (App. C at 7c.)

The SEC appealed the denial of its motion to the District Court. The District Court reversed the decision of the Bankruptcy Court, resting its conclusion on "the general rule that proceedings for adjustment of publicly held debt should appropriately be in Chapter X." (App. B at 7b.)

Petitioners, CIC, and the Creditors Committee all appealed. On October 27, 1978, the Court of Appeals affirmed. It held that "the Supreme Court has established a two-step test to determine whether a corporate rehabilitation affecting publicly held debt can go forward

in Chapter XI or must be transferred to Chapter X." (App. A at 9a.) The Court of Appeals then concluded that CIC had not satisfied the first step because its Chapter XI plan included a "major [reorganization] of publicly held debt where the investors are many and widespread." (*Id.* at 16a.) The Court of Appeals therefore did not even consider what it regarded as the second step—a weighing of each of the factors relating to the "needs to be served" by the bankruptcy process.

REASON FOR GRANTING THE WRIT

Certiorari Should Be Granted Because the Court of Appeals' Decision Conflicts With Applicable Decisions of This Court and Other Courts of Appeals on an Important Question Regarding Administration of the Bankruptcy Laws.

This Court has three times considered the principles for deciding whether Chapter X or Chapter XI is the appropriate vehicle for reorganization in a given case. *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965); *General Stores Corp.* v. *Shlensky*, 350 U.S. 462 (1956); *SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434 (1940). The choice between Chapter X and Chapter XI is invariably an important one because of the expense, disruption, and delay inherent in Chapter X's cumbersome procedures. Hence, in every case the question is unavoidable whether the huge "transaction costs" imposed by Chapter X—which reduce the total amount available to be shared among creditors and owners—can be justified by a real need to provide the formal protections of Chapter X. Contrary to the rule laid down by the Court of Appeals in this case, Chapter X imposes severe costs on both the debtor and the courts. A trustee must be appointed (11 U.S.C. § 556); he must conduct an investigation under court

[the answer to that question is not automatic.]

supervision into the affairs of the debtor (§ 567); he must prepare a plan of reorganization (§ 569); the SEC must comment on the plan to the court (§ 572); and the court must determine that the plan is "fair and equitable" (meaning that the plan adheres to the rule of "absolute priority") and feasible (§§ 574, 621) before shareholder and creditor approval for the plan is solicited (§ 576).

By contrast, Chapter XI relies primarily on private negotiation to develop a plan and the business judgment of affected persons to protect their own interests. The debtor typically remains in possession and its management is responsible for formulation of a plan (§§ 706(1), 723, 742, 757); if the necessary consents are obtained, the court need only find that the plan is feasible and in the best interests of the creditors before it orders that the plan be implemented (§ 766).

The Bankruptcy Act does not specify any criteria for determining whether Chapter X or Chapter XI is appropriate in any given case. It does, however, imply some preference for the simpler Chapter XI by providing that filing in Chapter X is improper if "adequate relief would be obtainable . . . under the provisions of chapter XI. . . ." (§ 546.)

In *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965), this Court recognized that, as a general rule, restructuring a large company with widespread public securityholders will require the mechanisms of Chapter X. But that opinion also makes it absolutely plain that the choice between Chapter X or Chapter XI is not determined simply by the size of the company or the structure of its debt. Rather, it depends on whether, in the circumstances of the case, the needs of the securityholders and the debtor require that the more onerous Chapter X proceedings be imposed on the debtor and the courts. *Id.* at 607-613; *see General Stores Corp.* v. *Shlensky*, 350 U.S. 462, 466 (1956). Moreover, the fundamental question in assessing the "needs to be served" is whether

> "the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems"

that can be obtained only from the more cumbersome Chapter X procedures. *American Trailer Rentals*, 379 U.S. at 608, *quoting United States Realty & Improvement Co.*, 310 U.S. at 448-49 n.6. Transfer to Chapter X is inappropriate if the safeguards afforded under Chapter X can be satisfied in a Chapter XI proceeding, even though the proposed restructuring affects the rights of public shareholders or creditors. *E.g.*, *In re KDI Corp.*, 477 F.2d 726, 735 (6th Cir. 1973); *SEC* v. *Crumpton Builders, Inc.*, 337 F.2d 907, 911 (5th Cir. 1964).

In this case, despite the Bankruptcy Court's conclusion that the "needs to be served" were adequately served in CIC's Chapter XI proceeding and the overwhelming approval of the parties in interest, the Court of Appeals (and the District Court) concluded that *American Trailer Rentals* established an absolute rule that a significant restructuring of widespread public debt must proceed in Chapter X. This holding is in fact contrary to the principles enunciated in *American Trailer Rentals* and in this Court's other decisions.

American Trailer Rentals indicates that an assessment of the "needs to be served" in a bankruptcy reorganization must include such diverse

> "factors as requirements of fairness to public debtholders, need for a trustee's evaluation of an accounting from management or determination that new management is necessary, and the need to readjust a complicated debt structure requiring more than a

simple composition of unsecured debt." 379 U.S. at 610.

But the Court of Appeals in this case singled out the last of these examples—"the need to readjust a complicated debt structure . . ."—and held that "this one factor requires transfer to Chapter X." (App. A at 9a.) Thus the Court of Appeals transformed what this Court advanced in *American Trailer Rentals* as a "general rule" admitting of exceptions, 379 U.S. at 613, 616, into the sort of "absolute rule" that neither Congress, nor this Court, intended. *Id.* at 613.[6]

The Court of Appeals reached this erroneous conclusion because it read *American Trailer Rentals* to lay down a mechanical rule that only a "simple composition" may proceed in Chapter XI. (App. A at 9a.) But *American Trailer Rentals* does not hold that a rehabilitation plan that is capable of being carried out under Chapter XI must be transferred to Chapter X merely because it is complex or substantial. To the contrary, while Chapter XI's scope will sometimes be inadequate to accommodate needed changes, *American Trailer Rentals* recognizes the requirement for a determination in each case of "the needs to be served": "A Chapter X petition

[6] The Court of Appeals relied heavily on the statement in *American Trailer Rentals* that in that case

> "public debts [were] being adjusted. The investors [were] many and widespread, not few in number intimately connected with the debtor, and the adjustment is quite major and certainly not minor. These facts alone would require Chapter X proceedings under the above-stated principles." 379 U.S. at 615.

The Court of Appeals took this passage to mean that the complicated debt reorganization contemplated in that case, by itself, required as a matter of law that the matter proceed in Chapter X. But the Court of Appeals appears to have misread the case. In the quoted passage the Court was addressing only the "general rule" that complicated reorganizations call for Chapter X, a rule which admits of exception where the needs to be served can be satisfied in Chapter XI. Indeed, the next paragraph of the Court's opinion (on p. 616), which speaks of the "general rule," appears to confirm that the Court of Appeals' reading is incorrect.

may not be filed unless 'adequate relief' is not obtainable under Chapter XI [Bankruptcy Act] § 146(2) [11 U.S.C. § 546(2)]." 379 U.S. at 607. And the adequacy of relief obtainable under Chapter XI depends on "the needs to be served." Since these needs are met by the Chapter XI procedure followed in this case, transfer to Chapter X was not proper.[7]

The mechanical rule adopted by the Court of Appeals is not only inconsistent with *American Trailer Rentals*, it is also in irreconcilable conflict with decisions from other Courts of Appeals.[8] For example, the Third Circuit permitted the Penn Central Company, the publicly owned parent of the Penn Central Railroad, to be reorganized in Chapter XI, on the ground that "no absolute rule governs whether a reorganization should be accomplished under Chapter XI." *In re Penn Central Co.*, Nos. 78-1715, 78-2321, 78-2336, slip op. at 24 n.10

[7] *American Trailer Rentals* observers in *dicta* that

> "Chapter X is still the appropriate proceeding where the debtor has widespread public stockholders and the protection of the public and private interests involved afforded by Chapter X are required because, for example, there is evidence of management misdeeds for which an accounting might be made, there is need for a new management, or the financial condition of the debtor requires more than a simple composition of its unsecured debts." 379 U.S. at 615.

Obviously this passage does not mean that incidence of one of the three enumerated factors would absolutely require proceeding in Chapter X if Chapter X type protections can be otherwise secured. For example, if management was faulty but has already been replaced, then there may be no need for Chapter X. *E.g., In re KDI Corp.*, 477 F.2d 726, 738 (6th Cir. 1972). Similarly, where a restructuring of debt may be substantial, but all the public and private interests involved have been adequately protected by alternative procedures, Chapter X procedures need not be invoked.

[8] Other courts are in general agreement that the "general rule" of *American Trailer Rentals* and its antecedents is merely a corollary of the "needs" analysis. *See, e.g., Norman Finance & Thrift Corp.* v. *SEC*, 415 F.2d 1199 (10th Cir. 1969); *In re Peoples Loan & Investment Co.*, 410 F.2d 851 (8th Cir. 1969).

(3d Cir. Jan. 11, 1979). Similarly, in *In re Alrac Corp.*, 550 F.2d 1314 (2d Cir. 1977), the debtor was permitted to proceed in Chapter XI even though its Chapter XI arrangement called for issuance of 1.5 million new shares in the debtor, and would affect the debtor's publicly held debt. The Second Circuit approved Chapter XI proceedings in *Alrac* primarily on the grounds that (1) "there was no assurance that the debtor would survive the rigors of Chapter X"; (2) "there was no need for an independent trustee"; (3) the "Chapter XI arrangement [was] overwhelmingly approved by the holders of the debtor's public debt"; and (4) "the adjustment of publicly held debt was not so substantial as to outweigh the factors favoring Chapter XI treatment." 550 F.2d at 1319.[9]

The Court of Appeals' decision is unreasonable as well. The effect of the rigid rule advanced by the Court of Appeals is to require the Bankruptcy Court to re-open and re-resolve problems that have already been worked out in a fair and pragmatic fashion to the satisfaction of all those who have an economic interest in the debtor. While the Court of Appeals believed that its rigid rule approach had the "merit of simplicity," in fact it represents a false economy. The Court of Appeals' approach may simplify its own task, but it does so only by saddling interested parties, Bankruptcy Courts, and District Courts with inherently complex, invariably lengthy, and

[9] The Court of Appeals attempted to distinguish *Alrac*, and thus to avoid a conflict. But in discussing the substantiality and impact of the *Alrac* plan of arrangement, the Court of Appeals' analysis ignores the fact that that arrangement involved issuance of 1.5 million shares of stock (more than the 1,043,056 already outstanding), which would quite obviously affect the 1,500 equity owners of the corporation. Even more fundamentally, the Court of Appeals' rigid approach in this case is simply irreconcilable with the *Alrac* court's flexible weighing of the "substantiality" of the adjustment of publicly held debt against "the factors favoring Chapter XI treatment." 550 F.2d at 1319.

wholly avoidable Chapter X proceedings in cases that could adequately be resolved in Chapter XI.

In addition, review of this case is important to preclude the SEC from usurping the judiciary's role in determining whether Chapter X or Chapter XI is the appropriate vehicle for relief in a given case. The SEC contends that it has discretion to decide whether or not to move to transfer a case to Chapter X, and it has acknowledged that it often declines to move to transfer, even when the debtor is a large company and substantial and complex restructuring of publicly held debt is required, "where it appears that in a particular Chapter XI case the public investors are fairly treated." [10] At the same time, however, the SEC contends that when it does decide to move to transfer its motion must be granted automatically.

Noting SEC practice in this regard, the House Report on the Bankruptcy Reform Act of 1978 critically observed that usually "a motion for conversion [from Chapter XI to Chapter X] by the Securities and Exchange Commission . . . is used as a bargaining tool to extract concessions from a debtor in the formulation of the plan." [11] While this alone might not be enough to warrant review, the practical effect of the rule adopted in this case is. For it permits the SEC to do precisely what it contends the bankruptcy courts cannot do—evaluate whether, in the circumstances of a given case, the needs of the public or other circumstances require the more onerous procedures of Chapter X, or whether Chapter XI proceedings may be adequate.[12] It is difficult to recon-

[10] SEC Brief on Appeal, p. 49.

[11] H.R. Rep. No. 595, 95th Cong., 1st Sess. 223 (1977).

[12] Many complicated restructurings of publicly held debt in Chapter XI have gone unchallenged by the SEC. Some of these cases are summarized in the District Court Brief of Debtor/Appellee Continental Investment Corporation, Appendix A (January 17,

cile the absolute rule advocated by the SEC in the cases it chooses to litigate and adopted by the Court of Appeals —that fairness to public debtholders always requires Chapter X treatment for significant restructurings— with the SEC's own more flexible and pragmatic practice.

Congress' enactment of the Bankruptcy Reform Act of 1978, 92 Stat. 2549 (1978), further demonstrates the appropriateness of review in this case. The legislative history of this new statute demonstrates clearly Congress' approval of the use of Chapter XI procedures in cases such as CIC's even before passage of the Reform Act, as well as Congress' intent to permit restructurings such as CIC's in the future to utilize flexible new facilities that are far more akin to Chapter XI than to Chapter X.[13]

In enacting the Reform Act, the terms of which become effective in October 1979, Congress abolished Chapter X. A bill supported by the SEC, which would have singled out "public companies" for special Chapter X-like treatment, was abandoned by Congress in favor of a single general procedure in all cases. In adopting this approach Congress expressly rejected "the myth

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1977), a copy of which is reproduced as Appendix F to this petition. Indeed, the interested parties in this case believed that the SEC would not attempt to force CIC into Chapter X. As the Bankruptcy Judge found, the SEC did not advise CIC during the six months of negotiations concerning CIC's solicitation materials that it would seek to have the case transferred to Chapter X. App. C at 5c.

[13] In a letter to the Clerk of the Court of Appeals dated October 26, 1978 (Appendix G), Counsel for CIC invited the Court of Appeals' attention to the legislative history of the Reform Act even before it was signed into law by the President. The Court of Appeals' printed opinion was issued the following day, October 27, 1978, however, and thus did not take note of those legislative developments. *See* App. A at 2a. The Court of Appeals entered an order noting a technical correction to its opinion on October 31, 1978, but that correction also does not address the legislative history of the Reform Act, which had not yet been enacted. *Id.* at 19a.

that provisions similar to those contained in Chapter X are necessary for the protection of public investors." [14]

Congress rejected the Chapter X model in its Reform Act because disclosure requirements and other developments in securities regulation introduced since enactment of the Chandler Act in 1938 independently assure public investors much of the protection sought to be afforded in Chapter X; [15] because Chapter X-type procedures almost inevitably involve costly (and sometimes disastrous) delay that injures creditors and debtors alike; [16] and because such "complicated and time-consuming provisions" are "not always necessary for the successful reorganization of a company with public debt." [17] Rather, Congress found that "the more flexible provisions in Chapter XI permit a debtor to obtain relief under the Bankruptcy Act in significantly less time than is required to confirm a plan of reorganization under Chapter X. . . ." [18], and that "[o]ne cannot overemphasize the advantages of speed and simplicity to both creditors and debtors." [19]

The same reasons, of course, militate in favor of proceeding in Chapter XI rather than Chapter X under existing law when the "needs to be served" can be and

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[14] 124 Cong. Rec. S17,418 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini); *id.* at H11,100 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards). There was no Conference Report on the Reform Act; the remarks of Senator DeConcini and Representative Edwards, the Committee Chairmen in charge of the legislation, took the place of a conference report and should be accorded similar respect. *Id.* at H11,088 (remarks of Rep. Rousselot).

[15] *Id.* at S17,418 (daily ed. October 6, 1978) (DeConcini); *id.* at H11,102 (daily ed. Sept. 28, 1978) (Rep. Edwards).

[16] *Id.* at S17,418 (DeConcini); *id.* at H11,102 (Edwards).

[17] *Id.* at S17,418 (DeConcini); *id.* at H11,102 (Edwards).

[18] *Id.* at S17,418 (DeConcini); *id.* at H11,102 (Edwards).

[19] *Id.* at S17,418 (DeConcini); *id.* at H11,102 (Edwards).

have been served in Chapter XI. Indeed, Congress specifically cited with approval in the legislative history of the Reform Act a number of cases under existing law in which publicly held companies of substantial size had sought restructuring in Chapter XI.[20] This Congressional action confirms the correctness of the Bankruptcy Court's decision in refusing to require CIC to proceed in Chapter X. Even if the law were previously open to some doubt it is clear that the existing statutory provisions should now be interpreted to conform with the policy of Congress' most recent enactments—and thus to permit CIC's reorganization in Chapter XI.[21]

Unfortunately, however, enactment of the Reform Act alone will not lay to rest the mechanical rule adopted by the Court of Appeals in this case. While the Reform Act eliminates Chapter X, it resurrects the problem of choosing between Chapter X and Chapter XI in only slightly different clothes: Under the new Chapter XI the Bankruptcy Court will be required to decide in cases like this one whether or not "cause" exists to appoint a trustee. Bankruptcy Reform Act of 1978, § 1104(a), 92 Stat. 2627. Left unreviewed, the likelihood is substantial that the mechanical rule adopted by the Court of Appeals in this case will be applied by courts seeking to determine when "cause" exists under the Reform Act provisions to appoint a trustee. Indeed, this is precisely what the SEC said when it proposed that Congress adopt the SEC approach in the Reform Act. The SEC specifically warned that the issues arising in litigation over transfer between Chapter XI and Chapter X "will only

[20] *See id.* at S17,418 (Sen. DeConcini: referring to cases of Daylin, Inc.; Colwell Mortgage Investors; National Mortgage Fund; Esgrow, Inc.; Sherwood Diversified Services, Inc.; Sheffield Watch Corp.; and United Merchants and Manufacturers, Inc.); *id.* at H11,101-02 (Edwards: referring to same cases).

[21] *E.g., In re petition of Chin Thloot Har Wong*, 224 F. Supp. 155 (S.D.N.Y. 1963).

shift . . . to the need for the appointment" of a trustee under the new statute.[22]

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the First Circuit.

Respectfully submitted,

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[22] *Hearings on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 624 (1977). The SEC's comments were offered in support of a bill that would specify that a trustee would be appointed in each case involving a "public company," defined as a company with 1,000 or more securityholders and $5,000,000 or more in certain debts. The SEC's comments were directed specifically against the House bill, H.R. 8200, which, as it then stood, provided only very general standards for determining whether a trustee should or should not be appointed. H.R. 8200 was subsequently amended, before it was enacted, to provide that "the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor" are not to be taken into account in determining whether a trustee should be appointed. Bankruptcy Reform Act of 1978, §§ 1104(a)(1) and (2), 92 Stat. 2627. Sections 1104 (a)(1) and (2) do not specifically address the kind of absolute rule adopted by the Court of Appeals, however.

78-1168

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-

MONTE J. WALLACE AND NEIL W. WALLACE,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION, CONTINENTAL INVESTMENT CORPORATION, AND CREDITORS COMMITTEE OF CONTINENTAL INVESTMENT CORPORATION,
Respondents.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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INDEX OF APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

Nos. 78-1204
78-1205
78-1238

In re
CONTINENTAL INVESTMENT CORPORATION,
Debtor,

MONTE J. WALLACE AND NEIL W. WALLACE,
CONTINENTAL INVESTMENT CORPORATION,
AND CREDITORS' COMMITTEE,
Appellants,

v.

SECURITIES AND EXCHANGE COMMISSION,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

[HON. FRANK J. MURRAY, *U.S. District Judge*]

Before COFFIN, *Chief Judge,*
CAMPBELL and BOWNES, *Circuit Judges.*

Charles P. Normandin, with whom *Richard W. Southgate*, *Reed Witherby*, and *Ropes & Gray*, were on brief, for Continental Investment Corporation.

Frederick G. Fisher, Jr., with whom *Hale & Dorr*, was on brief, for Creditors Committee.

Arthur F. Mathews, with whom *Irving Widett*, *Stephen F. Gorden*, *Widett, Widett, Slater and Goldman, P.C.*, *Michael R. Klein*, *Alexander F. Wiles*, and *Wilmer, Cutler & Pickering*, were on brief, for Monte J. Wallace and Neil W. Wallace, intervenors.

David Ferber, Solicitor to the Commission, with whom *Marvin E. Jacob*, Associate Administrator, *Jerome Feller*, Special Counsel, *Philip M. Mandel*, Special Counsel, and *Irving H. Picard*, Assistant General Counsel, were on brief, for Securities and Exchange Commission.

October 27, 1978

COFFIN, *Chief Judge*. The debtor, Continental Investment Corporation (CIC), a committee of its creditors, *see* 11 U.S.C. § 738, and the debtor's principal stockholders have appealed from the decision of the district court granting a motion by the Securities and Exchange Commission (SEC) to transfer proceedings from Chapter XI to Chapter X of the Bankruptcy Act pursuant to 11 U.S.C. § 728.[1] We are required to explore the boundaries

[1] Section 328 of the Bankruptcy Act, 11 U.S.C. § 728 reads:

"The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under chapter 10 of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of chapter 10 for the filing of a debtor's petition or a creditor's petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition . . . such amended petition or creditors' petition shall thereafter . . . be deemed to have been originally filed under such chapter."

of the rule promulgated by *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965), and the extent of its exceptions.

CIC is a holding company operating through subsidiaries providing financial services. In 1974 CIC defaulted first on obligations to 16 banks holding senior debt and then on interest payments to subordinated public debentureholders. As a consequence, negotiations began among CIC, the banks, a Debentureholders Protective Committee formed by institutions holding about ten per cent of the outstanding debentures, and another institutional holder of 16 per cent of the debentures. These negotiations produced a plan of arrangement agreed to in principle by all parties on July 29, 1975, and filed under Chapter XI on April 30, 1976. *See* 11 U.S.C. § 723. Before filing the plan CIC submitted it to its public stockholders and debentureholders via a combined registration and proxy statement processed by the SEC. About 90 per cent of the stockholders and 82 per cent of the debentureholders approved the plan. The percentage of debentureholders had risen to about 90 by the date of the district court opinion.

As of June 30, 1975, CIC owed the banks about $61,000,000. As part of the agreement, but not contingent upon the Chapter XI proceedings, the banks purchased one of CIC's subsidiaries for $34,000,000, reducing the senior debt to $27,000,000. Under the plan of arrangement, if approved, the banks would receive $20,000,000 in Senior Term Notes and $7,000,000 in Senior Preferred Stock with attached warrants to purchase 600,000 shares of CIC common stock.

CIC owed the approximately 1,600 public investors about $42,000,000 as of May 1, 1975. Under the plan

they would receive $3,500,000 of Subordinated Interest-Inclusive Debentures, $22,500,000 of Junior Preferred Stock, and $16,000,000 of Convertible Preferred Stock. The Junior Preferred Stock carries warrants to buy 1,780,000 shares of common stock, and the convertible stock can be converted to 4,000,000 shares. Dividends on the new securities will be paid only if all more senior obligations are satisfied. Unpaid dividends will not accumulate. The holders of the Convertible Preferred Stock will elect a majority of the board of directors of CIC. If all warrants were exercised and all convertible shares converted, the outstanding common stock would be diluted by about one-third.

The plan's purpose is to greatly reduce CIC's annual debt service obligations. Combined with steps already taken by management to divest CIC of marginal and unprofitable subsidiaries and to reduce costs, the parties hope to return CIC to profitable operation. Indeed CIC has been able to produce positive operating revenue in 1976 and 1977.

On June 18, 1976, six weeks after the Chapter XI petition was filed, the SEC moved the bankruptcy judge to transfer the proceedings from Chapter XI to Chapter X. The bankruptcy judge denied the motion without making explicit reference to *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965), and confirmed the plan. The district court reversed, holding that *American Trailer Rentals* required the case to proceed in Chapter X. This appeal is taken from the district court's order.

Our starting point for analysis must be *American Trailer Rentals*, wherein Justice Goldberg, speaking for a unanimous Court, explained in great detail the relationship between Chapters X and XI and the factors determining the choice between those chapters in a particular case. Though the decision to transfer is committed to the district court's discretion, *Schreibman* v.

Mason, 377 F.2d 99, 102 (1st Cir. 1967); *see* 11 U.S.C. § 728 (note 1, *supra*), that discretion must be exercised in reliance on the principles stated in *American Trailer Rentals*, 379 U.S. at 619, which reaffirms and explains the decisions in *General Stores Corp.* v. *Schlensky*, 350 U.S. 462 (1956), and *SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434 (1940).

The Supreme Court's examination of the legislative history [2] of the Bankruptcy Act revealed that Chapter XI was created "to provide a quick and economical means of facilitating simple compositions among general creditors who have been deemed by Congress to need only the minimal disinterested protection provided by that Chapter." 379 U.S. at 606-07. The purpose of Chapter X, on the other hand, is "to afford greater protection to creditors and stockholders by providing greater judicial control over the entire proceedings and impartial and expert administrative assistance . . . through appointment of a disinterested trustee and the active participation of the SEC." 379 U.S. at 604. "The basic assumption of Chapter X . . . is that the investing public dissociated from control or active participation in the management, needs impartial and expert assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems." 310 U.S. at 448-49 n.6.

On the basis of the above distinctions, Congress drafted the two chapters to meet different ends. "In enacting these two distinct methods of corporate rehabilitations, Congress has made it quite clear that Chapters X and XI are not alternate routes, the choice of which is in the hands of the debtor. Rather, they are legally, mutually exclusive paths to attempted financial rehabilitation." 379 U.S. at 607. *Compare* 11 U.S.C. § 546(2)

[2] We rely on the Supreme Court's fuller discussion of the legislative history of the Bankruptcy Act in *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594, 603-07 (1965).

with 11 U.S.C. § 728. Congress has allocated corporate rehabilitation schemes between Chapters X and XI on the basis of assumptions properly within the legislative domain. The task of the courts is to determine in which chapter a particular scheme belongs.

The Supreme Court has rejected the SEC's suggestion that the structure of a corporation or the structure of its public debt automatically determines the appropriate chapter. All corporations with public investors need not submit to Chapter X, 379 U.S. at 607, nor must all cases directly affecting the rights of public investor creditors of a publicly held debtor proceed in Chapter X, 379 U.S. at 611. The Court has, however, endorsed a general rule that normally Chapter X is "adapted to the reorganization of corporations with complicated debt structures and many stockholders" and Chapter XI is adapted "to composition of debts of small individual business and corporations with few stockholders", 379 U.S. at 608, *quoting United States Realty*, 310 U.S. at 447. CIC does have a complicated debt structure and many stockholders. Therefore, it falls within the general rule.

The fact that the Court has chosen a general rule rather than an absolute rule means, of course, that there are exceptions. But the exceptions are very narrow, 379 U.S. at 614, and must be related to the unique purposes of Chapter XI. *United States Realty*, which first expressed the general rule, pointed out that "[a] large company with publicly held securities may have as much need for a simple composition of unsecured debts as a smaller company. And there is no reason we can see why c. XI may not serve that end." 359 U.S. at 466. *American Trailer Rentals* elaborated on the purpose of the exception. " 'Simple' compositions are still to be effected under Chapter XI. Such a situat[illegible] even where public debt is directly affected may exist, for example, where the public investors are few in number and familiar with the operations of the debtor, or where, although the public investors are greater in number, the adjustment of their debt is relatively minor, consisting, for example, of a short extension of time for payment." 379 U.S. at 614. These two situations are given only as examples. The Court has not excluded the possibility that there may be other situations in which the rights of public investor creditors can be adjusted in Chapter XI. We conclude, however, that any such situations would have to fall within the definition of "simple composition".[3] Neither *American Trailer Rentals* nor *United States Realty* gives any indication that the narrow exception to the general rule can extend beyond simple compositions.

Moreover, extending the exception beyond simple compositions would frustrate the legislative assumptions as explained by the Court and set out above. For if a substantial number of public investors are involved in any reorganization the fairness of which is not facially apparent, a decision to allow the matter to proceed in Chapter XI is to substitute a court's faith in the goodwill, fairness, and competence of those representing the debtor and the creditors for the congressionally mandated protections of Chapter X.

We are bolstered in this reading of *American Trailer Rentals* by other passages in the opinion. The clearest statement comes in the Court's application of the rule to the facts of that case:

> "Here public debts are being adjusted. The investors are many and widespread, not few in number inti-

[3] The Supreme Court uses the term "simple composition" as the complement of "major reorganization". We think it clear that "simple composition" includes minor reorganizations directly affecting publicly held debt where the public impact is minimized, for instance, by the small number of public investors or their close ties to the debtor's operations. 379 U.S. at 614.

mately connected with the debtor, and the adjustment is quite major and certainly not minor. *These facts alone would require Chapter X proceedings under the above-stated principles.*" 379 U.S. at 615 (emphasis added).

The Court's ensuing discussion of facts indicating management wrongdoing and the need for an independent trustee are additional factors not necessary to the holding in that case. Later, in a footnote discussing the scope of discretion accorded the district court, the Court refers to the factual question "whether or not that particular debtor needed a more pervasive reorganization than a simple composition under Chapter XI." 379 U.S. at 619 n.18. The phrasing of this question indicates that pervasive reorganizations belong in Chapter X. *See* 379 U.S. at 614-15.

All parties concede that the reorganization proposed in this case is major, greatly altering the rights of numerous widespread public investors.[4] Therefore, this corporate rehabilitation, if it is to go forward at all, must proceed in Chapter X. It is the exact kind of case for which Congress intended Chapter X.

We do not think our holding or our reasoning is in any way inconsistent with the Supreme Court's repeated

[4] Under the plan of arrangement, the debtor would have eight layers of securities. The banks would hold $20,000,000 of Senior Term Notes, $7,000,000 of Senior Preferred Stock, and warrants attached to the preferred stock to purchase 600,000 shares of common stock. The public debentureholders would have $3,500,000 of Subordinated Interest-Inclusive Debentures, $22,500,000 of Junior Preferred Stock, warrants attached to the preferred stock to buy 1,780,000 shares of common stock, and $16,000,000 of Convertible Preferred Stock. The holders of the existing 13,000,000 shares of common stock would retain those shares. All of the various layers above the common stock would be newly created. Currently CIC's capital structure is relatively simple, consisting of two issues of subordinated debentures, one due in 1985 and the other in 1990, as well as the common stock and the bank debt.

statements that the particular "needs to be served" rather than an absolute rule should control the outcome. *See, e.g.*, 379 U.S. at 610; 350 U.S. at 466. One of the factors determining the needs to be served is "the need to readjust a complicated debt structure requiring more than a simple composition of the unsecured debt." 379 U.S. at 610; 350 U.S. at 467. We interpret *American Trailer Rentals* to hold that this one factor requires transfer to Chapter X. Only where it is absent is it possible for a reorganization affecting publicly held debt to go forward in Chapter XI. When the reorganization is not major the court must go on to consider other factors such as whether "there is evidence of management misdeeds for which an accounting might be made, . . . a need for new management, or the financial condition of the debtor requires more than a simple composition of its unsecured debts." 379 U.S. at 615. These factors must then be weighed to determine whether Chapter X or Chapter XI best serves the particular needs of a debtor and its public investors.

To sum up, we think the Supreme Court has established a two-step test to determine whether a corporate rehabilitation affecting publicly held debt can go forward in Chapter XI or must be transferred to Chapter X. First, looking at the plan of arrangement the court must decide whether the plan proposes a major reorganization or a simple composition. Only the latter is eligible for Chapter XI treatment. Relatively minor adjustments of publicly held debt may be simple compositions. *See* 379 U.S. 614; note 4, *supra*. Second, if the proposed plan gets by the first test—if it does not outline a major reorganization—then the court must go beyond the face of the plan to examine such factors as "requirements of fairness to public debt holders, need for a trustee's evaluation of an accounting from management or determination that new management is necessary, and the need to readjust a complicated debt struc-

ture requiring more than a simple composition of unsecured debt." 379 U.S. at 610; 350 U.S. at 466-67.[5] There need not be a detailed weighing of factors where the plan proposes a major reorganization. Conversely a proposed simple composition cannot escape careful factual analysis.

Appellants argue with some force that in many ways this reorganization, though major, is appropriate for Chapter XI. They suggest that many of the safeguards provided by Chapter X have been taken care of or are not needed in this case. The creditors, on their own behalf, have investigated the debtor, and the bankruptcy judge found "that there is insufficient evidence in the record to warrant a finding that a further investigation of the affairs of the debtor by an independent trustee would be either useful or productive." Some doubt is cast on the adequacy of the investigation both by the fact that its results do not appear in the record and by the district court's finding that "there is need of an independent investigation into the pending lawsuits against CIC to establish whether there is likelihood that present management would continue to operate for the best interests of the public investors."[6] It is clear, however,

[5] The last factor listed is not simply a restating of the first step test. Rather it requires a court to consider whether a plan proposing a simple composition will adequately rehabilitate the corporation, or whether a more pervasive plan will ultimately be necessary.

[6] The Federal Rules of Bankruptcy, Rule 810, extend the clearly erroneous rule to bankruptcy proceedings. "The court shall accept the referee's findings of fact unless they are clearly erroneous, and shall give due regard to the opportunity of the referee to judge of the credibility of the witnesses." Our holding, of course, does not turn on whether or not we accept the district judge's finding. In any event, in this instance, we see no conflict between the finding of the bankruptcy judge and the district court. The bankruptcy judge spoke only of "the affairs of the debtor" and rejected the need for further investigation for lack of evidence. He did not mention the pending litigation against the debtor. Strictly speaking, this litigation may not be one of "the affairs of the debtor." But even if it were, the district judge was entitled to consider it important and arrive at the "firm conviction that a mistake ha[d] been committed." *Id.*, Editorial Comment, § 810.1.

that this is not the case contemplated by Congress where the creditors were forced to proceed without getting questions answered or solely on the basis of management representations.

Moreover, the parties to this negotiation were all sophisticated. The debentureholders' representatives were institutions with significant holdings capable of understanding the financial complexities and protecting their own interests. Though not intimately connected with the debtor, these were not the widespread public investors unable to band together or hire representatives to protect themselves and unable to understand their predicament whom Congress intended to protect. *See* 310 U.S. at 448-49 n.6. The parties to the negotiation were dealing at arm's length. None of them represented more than one class of creditor or security holder. About ninety percent of CIC's shareholders and of the debentureholders[7] as well as every one of the banks holding senior debt have approved the plan.

The bankruptcy judge found that the plan so negotiated "is *feasible* and in the *best interests* of the creditors" (emphasis in original). All parties make significant sacrifices under the plan although no finding has been made that it is "fair and equitable" as would be required under Chapter X. 11 U.S.C. § 621(2). Unlike the situation in *American Trailer Rentals*, manage-

[7] The Second Circuit has said that "[w]hen confronted with a Chapter XI arrangement that is overwhelmingly approved by the holders of the debtor's public debt, as in this case, the courts are usually reluctant to order conversion to Chapter X." *In the Matter of Alrac Corp.*, 550 F.2d 1314, 1319 (2d Cir. 1977). But this reluctance cannot override the principles of *American Trailer Rentals. See Norman Finance and Thrift Corp.* v. *SEC*, 415 F.2d 1199, 1202 (10th Cir. 1969).

ment of the debtor here has not clearly been guilty of extensive misappropriation, self-dealing, or securities fraud. Present management has already divested CIC of many marginal and unprofitable subsidiaries and operated profitably in 1976 and 1977. The bankruptcy judge found "no evidence of wrongdoing on the part of the management of the debtor. There is insufficient evidence in the record to warrant a finding that new management of the debtor is needed.[8]

None of these factors, however, allow us to ignore Congress' division of corporate rehabilitations between Chapters X and XI. At best, the facts of this case suggest that some of the assumptions Congress made may be outmoded and have been overtaken by changing patterns of public investment. Perhaps the Bankruptcy Act now cuts too broadly in assuming that all public investors of corporations need SEC protection in order to make and safeguard their investment decisions. If so, though, Congress is the appropriate body to consider amending the law. A court cannot make an exception to a statutory rule on the basis of that court's determination that Congress established the rule on the basis of a faulty set of assumptions. And this court is bound by the Supreme Court's determinations of legislative history and purpose.

We would add one consideration of a more positive nature. The present litmus test, at least as we have interpreted the law, for determining whether the threshold requirement for Chapter XI has been met, i.e., whether nothing more than a simple composition affecting pub-

[8] The district court questioned this finding because it interpreted the facet of the plan giving the power of electing a majority of the board of directors to the debentureholders as indicating lack of confidence in the existing management. Giving the public investors veto power falls far short of finding that new management is needed. On this basis alone we could not reject the finding of the bankruptcy judge. *See* note 5, *supra*.

lic investors is contemplated, has the merit of simplicity. To the extent that complex arrangements be permitted to qualify for Chapter XI treatment, if widely approved, if deemed eminently feasible, if found "fair" to public investors, if the public investors are found to be fully informed, etc., judgment calls may vary and litigation is invited. Decisions ought not to turn on "the 'particular experience and predilections' of the district judge involved." 379 U.S. at 620, *quoting SEC* v. *Canandaigua Enterprises Corp.*, 339 F.2d 14, 19 (2d Cir. 1964).

Our decision is not irreconcilable with other courts' resolutions of the issue. The Second Circuit recently allowed a publicly owned corporation to proceed under Chapter XI with a plan for rehabilitation that directly affected publicly held debt. *In the Matter of Alrac Corp.*, 550 F.2d 1314 (2d Cir. 1977). The Second Circuit's analysis was somewhat different from ours in that it considered the extent of the reorganization as only one factor to weigh against others—particularly the likelihood that the debtor might not survive Chapter X proceedings, *see infra*, the fact that the debt holders had overwhelmingly approved the plan, and the fact that the SEC had not chosen to intervene. But it did conclude that in comparison to those factors the adjustment of the publicly held debt was insubstantial. Indeed, that plan called for full cash payment of that debt. "[T]he adjustment affected only the timing of the payments and the note holders' right to interest after August 20, 1974." *Id.* at 1319. Such an "adjustment of their debt is relatively minor" and may, therefore, qualify as a "simple composition" under *American Trailer Rentals*, 379 U.S. at 614, thus justifying the more probing second stage weighing process. Clearly the reorganization in our case, completely rearranging the relationship between the debtor and its creditors and introducing complicated new layers of securities, is far more pervasive than that in *Alrac*.

Similarly *In re KDI Corp.*, 477 F.2d 726 (6th Cir. 1973), is distinguishable. There the Sixth Circuit affirmed a denial of a motion to transfer the readjustment of debt of a public corporation from Chapter XI to Chapter X. The court acknowledged the Supreme Court's insistence that major reorganizations of public debt proceed in Chapter X, *id.* at 736, but found that KDI had no publicly held debt. Therefore it was appropriate for it to examine other factors to determine whether Chapter X might be required anyway. *Cf. Posi-Seal International, Inc.* v. *Chipperfield*, 457 F.2d 237 (2d Cir. 1972) (allowing Chapter XI where no prejudice to public investors and no public debentureholders); *Norman Finance and Thrift Corp.* v. *SEC*, 415 F.2d 1199 (10th Cir. 1969) (transferring to Chapter X where "drastic readjustment" of rights of public creditors); *In re Peoples Loan & Investment Co. of Fort Smith*, 410 F.2d 851 (8th Cir. 1969) (transferring to Chapter X where adjustment not minor); *Manufacturers Credit Corp.* v. *SEC*, 395 F.2d 833 (3d Cir. 1968) (transferring to Chapter X where radical readjustment of debt structure); *SEC* v. *Canandaigua Enterprises Corp.*, 339 F.2d 14, 21 (2d Cir. 1964) (requiring transfer to Chapter X when publicly held debt subjected to substantial adjustment departing from "fair and equitable" rule); *In re Meister Brau*, 355 F. Supp. 515 (N.D. Ill., 1972) (requiring transfer to Chapter X whenever complicated debt structure requires pervasive reorganization).

Appellants also pursue a distinct line of argument. They raise the possibility that the added delay, expense, and uncertaintly inherent in transferring the case to Chapter X at this point might doom the corporation to liquidation or at least needlessly weaken its recovery. Such considerations may not be legitimate ones. *SEC* v. *Burton*, 342 F.2d 783, 785 (1st Cir. 1965), *but see In the Matter of Alrac, supra*, 550 F.2d at 1319. Chapter X's very purpose is to insure an exhaustive investigation and

careful consideration of the interests of public investors. The essential question is whether such extra protection is required. It would be circular to find Chapter X were required but should not be resorted to because it would be too costly. It is natural for a debtor to prefer Chapter XI's speed and economy, but the Supreme Court took care in *American Trailer Rentals* to dispose of the argument:

> "In this area, as with other statutes designed to protect the investing public, Congress has made the determination that the disinterested protection of the public investor outweights the self-interest 'needs' of corporate management for so-called 'speed and economy.' In fact, experience in this area has confirmed the view of Congress that the thoroughness and disinterestedness assured by Chapter X not only result in greater protection for the investing public, but often in greater ultimate savings for all interests, public and private, than do the so-called 'speed and economy' of Chapter XI. . . . Moreover the requirements of Chapter X are themselves sufficiently flexible so that the District Court can act to keep expenses within proper bounds and insure expedition in the proceedings. We also reject respondent's further argument that the time and expense of a Chapter X proceeding would be so great that the ultimate result might be straight bankruptcy liquidation. . . . In addition to the above answers to respondent's general-time-and-expense argument, we feel compelled to point out, without indicating any opinion as to the ultimate outcome of the attempted financial rehabilitation in this case, that it must be recognized that Chapters X and XI were not designed to prolong—without good reason and at the expense of the investing public—the corporate life of every debtor suffering from terminal financial ills." 379 U.S. at 617-18 (footnotes and citations omitted).

Even if the arguments were legitimate, we could not assume that dire consequences must result. As the Court noted, Chapter X is flexible. If adequate investigations have in fact been carried out, the trustee ought to be able to compress his investigation accordingly. If the plan worked out is indeed the best one for all parties concerned, it is likely the trustee can utilize substantial parts of it. If the groundwork has all been laid, implementation of the final plan could be expedited. The bankruptcy judge noted that there is some uncertainty whether CIC would be able to take advantage of a $28,000,000 loss carry forward were the proceedings to be transferred to Chapter X. The outcome turns on congressional action, however, and we must assume that Congress has in mind the effect its tax laws have on its bankruptcy laws. We must assume that the result of the Chapter X proceedings will be the result intended by the law as administered to the best of all parties' abilities. Finally, we note that if delay does result, that delay is ultimately chargeable to the debtor for having failed to read *American Trailer Rentals* literally. The choice between Chapters X and XI is not left to the debtor, 379 U.S. at 607, and the Court stated in no uncertain terms that major reorganizations of publicly held debt where the investors are many and widespread must proceed in Chapter XI. 379 U.S. at 615.

Affirmed.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 78-1204.

IN THE MATTER OF:
CONTINENTAL INVESTMENT CORPORATION,
Debtor.

MONTE J. WALLACE, ET AL.,
Intervenors, Appellants.

No. 78-1205.

IN RE
CONTINENTAL INVESTMENT CORPORATION,
Debtor, Appellant.

No. 78-1238.

IN RE
CONTINENTAL INVESTMENT CORPORATION,
Debtor.

CREDITORS COMMITTEE,
Appellant.

JUDGMENT

Entered October 27, 1978

This cause came on to be heard on appeals from the United States District Court for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The orders of the district court are hereby affirmed.

By the Court:

/s/ Dana H. Gallup
Clerk.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 78-1204.

IN THE MATTER OF:
CONTINENTAL INVESTMENT CORPORATION,
Debtor.

MONTE J. WALLACE, ET AL.,
Intervenors, Appellants.

No. 78-1205.

IN RE
CONTINENTAL INVESTMENT CORPORATION,
Debtor, Appellant.

No. 78-1238.

IN RE
CONTINENTAL INVESTMENT CORPORATION,
Debtor.

CREDITORS COMMITTEE,
Appellant.

ORDER OF COURT

Entered: October 31, 1978

It is ordered that the opinion in the above entitled cases dated October 27, 1978, be amended as follows:

On page 16, line 5, the Roman numeral "XI" should be changed to Roman numeral "X".

By the Court:

DANA H. GALLUP, Clerk

By:/s/ Grace V. Carey
Senior Deputy Clerk.

APPENDIX B

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

No. 76-1158-M

In the Matter of
CONTINENTAL INVESTMENT CORPORATION,
Debtor

MEMORANDUM AND ORDER

MURRAY, *Senior District Judge*

This consolidated appeal presents the issues whether on the factual record the motion of the Secrities and Exchange Commission (SEC) to transfer the proceedings to Chapter X of the Bankruptcy Act should have been granted, and the plan of arrangement under Chapter XI approved, by the Bankruptcy Judge. Detailed findings and conclusions were filed by the Bankruptcy Judge after hearing the motion to transfer, and they need not be repeated here. The findings of fact are to be accepted "unless they are clearly erroneous". Rule 810, Rules of Bankruptcy Procedure.

In *SEC* v. *American Trailer Rentals*, 379 U.S. 594, 613, 615 (1964) the Court said:

> . . . [A]lthough there is no absolute rule requiring that Chapter X be utilized in every case in which the debtor is publicly owned, or even where publicly held debt is adjusted, as a general rule Chapter X is the appropriate proceeding for adjustment of publicly held debt.
>
> * * * *

> . . . [I]t is obvious that Chapter X is the appropriate proceeding for the attempted rehabilitation of respondent in this case. Here public debts are being adjusted. The investors are many and widespread, not few in number intimately connected with the debtor, and the adjustment is quite major and certainly not minor. These facts alone would require Chapter X proceedings under the above-stated principles.

I

Continental Investment Corporation (CIC) is a diversified financial services holding company operating through subsidiaries, whose operations have included mortgage insurance, life insurance, advising mutual funds and large private accounts, land development, and oil and gas development. In the case here on appeal CIC as of December 31, 1975 owed a group of 16 banks approximately $64 million, including principal and accrued but unpaid interest, on various loans extending back to 1973. Beginning late in 1974 and extending through 1975, negotiations were conducted among representatives of CIC, its lending banks, a Debentureholders Protective Committee, formed by institutions holding in the aggregate about 10 per cent of the outstanding debentures, and an additional institutional holder of approximately 16 per cent of the debentures. CIC entered into pledge agreements with the banks, whereby CIC pledged, *inter alia*, all of the outstanding common and preferred stock of Investors Mortgage Group, Inc. (IMG) and all of the outstanding common stock of ConVest Energy Corporation (ConVest), two of its subsidiaries, to secure payment of the bank debt. It also sold several other subsidiaries and curtailed its expenses, but the parties to the negotiations agreed that more drastic measures would be needed. In July of 1975 they executed a nonbinding agreement which contemplated a substantial restructur-

ing both of CIC's unsecured debt under a proposed Chapter XI arrangement and of CIC's debts to the banks, outside of the arrangement. The proposed restructuring was implemented in January of 1976 by an Omnibus Refinancing Agreement between CIC and the banks. Pursuant to that agreement, the banks purchased IMG, thus effecting a reduction of $34 million in CIC's debt to them.

In addition to the bank debt, which is the senior debt, the remaining debt and equity is as follows:

(a) $37,158,900 of 9% subordinated debentures due 1985 held by approximately 1,387 persons of record,

(b) $1,511,000 of 9% convertible debentures due 1990 held by approximately 255 persons of record, and

(c) 12,944,533 shares of 10-cent par value common stock owned by approximately 4,100 shareholders in the United States.

CIC defaulted in payment of interest due on both series of debentures; the accrued and unpaid interest as of April 30, 1976 approximated $6,960,000. The debentures have been declared due and payable.

The plan of arrangement under Chapter XI filed by CIC contemplated restructuring both of CIC's unsecured debt under Chapter XI, and, outside Chapter XI, of CIC's debt to the banks. Under the terms of arrangement, still to be carried out, the banks and debentureholders would receive, in exchange for the debts remaining, new issues of notes and securities. The details may be summarized:

(1) The banks are to accept $20 million in Senior Term Notes with an extended payout and a limited interest rate, with warrants attached, and $7 million in Senior Preferred Stock. The Senior Term Notes are to be paid in quarterly in-

stallments, the bulk of the total from 1979 to 1984. Should a final judgment against CIC in excess of $10,000 remain unpaid for more than 60 days, CIC would be in default on the Senior Term Notes, and they could be declared immediately due and payable.

(2) The debentureholders are to be issued $3.5 million of Subordinated Debentures, $22.5 million of Junior Preferred Stock with warrants attached, and $16 million of Convertible Preferred Stock. The Subordinated Debentures will be subordinate to the Senior Term Notes and to any other indebtedness of CIC for money borrowed but not to the Senior Preferred Stock. No interest will be paid on the Debentures; they are due in 1984, and CIC is to make annual payments to a sinking fund for their redemption.

(3) There are provisions for dividends for the new stock issues, but dividends for each are contingent upon CIC's compliance with the provisions of every issue more senior. There are also provisions for retirement or redemption of the new issues, and the dollar value assigned to them reflects the price CIC is to pay for them.

(4) If all the warrants for purchase of stock are exercised, and if all the Convertible Preferred Stock is converted, the presently outstanding Common Stock will be diluted by approximately 33 per cent. Until amortization and redemption payments aggregating $70 million and dividend payments of approximately $23 million are made with respect to the new issues, the holders of the new Convertible Preferred Stock will elect a majority of CIC's board of directors, and holders of the Common Stock will not participate in distribution of assets should CIC be liquidated.

The proposed arrangement would not affect CIC's trade debt. The obligation of the banks to go forward under this arrangement is conditioned upon confirmation of a Chapter XI plan for CIC. The Chapter XI plan has been approved by holders of 89 per cent of the stock outstanding, and by holders of 90 per cent of the debentures outstanding.

After sale or discontinuance of a number of its subsidiaries, CIC now has three in operation: Waddell & Reed, Inc. (W&R), United Investors Life Insurance Co. (UILIC), and ConVest. W&R serves as investment manager and distributor of a number of mutual funds, the largest of which is United Funds, Inc. In addition, a subsidiary of W&R manages a number of private accounts. W&R's sales representatives also distribute life insurance written by UILIC and oil and gas partnership units originated by ConVest, accounting in 1975 for the sales of about 95 per cent of the policies written and units sold.

II

This is obviously a case in which public debts are being adjusted, investors are numerous and widespread, and the debt adjustment is major. Moreover, although the Bankruptcy Judge found that there was no sufficient showing of need of new management of CIC, it is significant that the proposed plan provides for the transfer to the holders of the new Convertible Preferred stock power to elect a majority of the directors. Thus, the present holders of 76 per cent of the common stock would lose control over the management of CIC, and this strongly suggests a deliberate move to displace present management, or at least to closely monitor it with power to veto its policies and practices. This recognition by the creditors of the need to change control at the director level is evidence reflecting adversely on the present management and indicating the need for change.

The existence of several pending lawsuits in which CIC is a defendant has serious portent. These cases for the most part involve alleged contract violations or securities fraud on the part of CIC or its subsidiaries. In a number of them plaintiffs would have to pierce the corporate veil to reach CIC; a number of the others might be discharged by confirmation of a Chapter XI arrangement. Several of the cases allege willful torts, however, which would not be discharged under Chapter XI, and there is no way on the record before the court to forecast the outcome of these cases. In light of the provision of the refinancing arrangement specifying that existence of a judgment in excess of $10,000 not satisfied within 60 days constitutes default of the Senior Term Notes, the existence of these lawsuits constitutes a real threat to CIC's continuing operations.

SEC bases its argument for a transfer to Chapter X primarily on the case law, asserting that the facts here bring the case under the rule of *American Trailer Rentals*. That case clearly held, *inter alia*, that a district court does not have open-ended discretion to decide on a case-by-case basis "whether in its opinion it would be better for a particular debtor to be in Chapter X or Chapter XI". 379 U.S. at 619. The district court is required to observe and apply the principles of that case in reaching the factual question of whether or not the debtor is in need of a more pervasive reorganization or readjustment than is available under Chapter XI.[1] It is clear from the undisputed facts that there is need of an

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[1] "Simple" compositions are still to be effected under Chapter XI. Such a situation, even where public debt is directly affected may exist, for example, where the public investors are few in number and familiar with the operations of the debtor, or where, although the public investors are greater in number, the adjustment of their debt is relatively minor, consisting, for example, of a short extension of time for payment.

SEC v. *American Trailer Rentals*, 379 U.S. 594, 614 (1965).

independent investigation into the pending lawsuits against CIC to establish whether there is likelihood that present management would continue to operate for the best interests of the public investors.

The conclusion of the Bankruptcy Judge that there was no evidence that investigation of CIC's affairs by a trustee as contemplated by Chapter X would be useful or productive, and no evidence that terms more favorable to the public debtholders could have been negotiated, seems to imply the need of SEC to demonstrate the likelihood that reorganization under Chapter X could be accomplished. But the district court is not required in this proceeding to make that determination. It is enough to show that "all issues relevant to the possible financial rehabilitation of [the debtor] must . . . be determined within the confines of a Chapter X, rather than a Chapter XI, proceeding". *SEC* v. *American Trailer Rentals*, *supra* at 620, n.20. The pertinent facts here demonstrate that this case does not fall within the exceptions to the general rule that proceedings for adjustment of publicly held debt should appropriately be in Chapter X.

Accordingly, the orders of the Bankruptcy Judge are reversed, and the case is remanded to the Bankruptcy Court with directions to allow the motion to transfer the case to Chapter X.

/s/ Grant J. Murray
Senior District Judge

Dated March 31, 1978

APPENDIX C

UNITED STATES OF AMERICA
IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

No. 76-1158-G

In the matter of
CONTINENTAL INVESTMENT CORPORATION
Debtor

In Proceedings for an Arrangement under Chapter XI

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER IN THE MATTER OF MOTION BY THE SECURITIES AND EXCHANGE COMMISSION TO HAVE THIS CASE PROCEED UNDER CHAPTER X OF THE BANKRUPTCY ACT

INTRODUCTORY STATEMENT

This matter of the Motion by the Securities and Exchange Commission to have this case proceed under Chapter X of the Bankruptcy Act was brought on for hearing before the undersigned bankruptcy judge pursuant to Section 328 of the Bankruptcy Act (11 U.S.C. Sec. 728) and Rule 11-15 of the Bankruptcy Rules.

On April 30, 1976, the debtor, a Massachusetts corporation, filed its petition under Section 322 of the Bankruptcy Act (11 U.S.C. Sec. 722).

Pursuant to an Order of this Court, the debtor was continued in possession of its properties and assets.

The debtor is a diversified financial service holding company operating through subsidiaries.

Its liability and equity structure is as follows:

It has issued and there is outstanding 12,944,533 shares of .10 par value common stock, owned by approximately 4100 holders throughout the United States.

The debtor has outstanding two series of debentures:

1. 9% Subordinated Debentures due 1985 in an aggregate principal amount of 37,158,900 held by approximately 1387 persons of record.

2. 9% Convertible Subordinate Debentures due 1990 in an aggregate principal amount of 1,511,000 held by approximately 255 persons of record.

Several record owners are brokers holding in street name for the accounts of customers.

The debtor defaulted in the interest payments due on both series of debentures in November, 1974.

Accrued and unpaid interest as of April 30, 1976, the date on which these proceedings were commenced, totaled approximately 6,960,000.

The debentures have been declared immediately due and payable by the trustees under the indentures relating to the debentures.

Both series of debentures and the debtor's common stock were formerly listed for trading on the New York Stock Exchange but were delisted subsequent to the filing of the Chapter XI petition.

Debtor owes approximately $32 million for principal and accrued interest to a consortium of sixteen banks.

The bank debt has been declared immediately due and payable and by its terms ranks senior in right of payment to the debentures. The banks have entered into an Omnibus Refinancing Agreement with the debtor providing that the banks will accept $20 million in Senior Term Notes payable over a period of nine years and $7 million liquidation preference/redemption price of Senior Preferred Stock and warrants to purchase up to 600,000 shares of common stock in exchange for all outstanding bank debt provided the Plan of Arrangement filed in these proceedings is confirmed and consummated by December 31, 1976.

An ad hoc committee known as the Debentureholders Protective Committee was organized by a group of debentureholders in October, 1974, and has conducted an independent investigation of the debtor's pre-bankruptcy business activities and transactions. The debtor has adequately explained the history of its operations including the complex causes of its business failure.

Prior to the filing of the Chapter XI petition, various subsidiaries and business operations of the debtor which had been unprofitable were liquidated or sold. A major subsidiary which was profitable (Investors Mortgage Group, Inc.) was purchased by the debtor's lending banks on April 27, 1976, and the sum of $34,000,000 was credited to the bank debt then outstanding. The remaining subsidiaries of the debtor are Waddell & Reed, Inc. and its subsidiary, United Investors Life Insurance Co., which are engaged in the business of mutual fund management, distribution of mutual fund shares and other securities and the sale of life insurance, and ConVest Energy Corporation which is engaged in oil and gas exploration through a series of limited partnerships. They are not debtors within the jurisdiction of the Bankruptcy Court, and accordingly their operations are outside the jurisdiction of the Bankruptcy Court. The consolidated

operations of the debtor, including the operations of the wholly owned subsidiaries which are named above, would now be profitable, on a pro-forma basis, giving effect to confirmation and implementation of the proposed Plan of Arrangement.

It appears that the relationship of Waddell & Reed, Inc. to the mutual funds managed by it might be detrimentally affected by a conversion of these proceedings from Chapter XI to Chapter X. Since Waddell & Reed's salesmen also act as salesmen for United Investors Life Insurance Co. and participate in the offering of limited partnership interests by ConVest Energy Corporation, it appears that any detrimental effect suffered by Waddell & Reed, Inc. might adversely affect the operations of United Investors Life Insurance Co. and ConVest Energy Corporation.

The debtor has expended substantial efforts and incurred substantial expenses in negotiating and in obtaining Acceptances and Consents to the Plan of Arrangement, and in obtaining related stockholder approvals and reaching agreement with its lending banks. The fruits of all or part of said efforts and expenses will be lost if the present proceedings are converted from Chapter XI to Chapter X.

The debtor presently has a net operating tax loss carry forward for federal income tax purposes of approximately $28,000,000. This loss carry forward, if it can be utilized, represents a potential benefit to creditors of several million dollars. There is a probability that said loss carry forward can be preserved and at least partially utilized, for the benefit of creditors and the debtor, if the Plan of Arrangement is confirmed. If the proceedings are converted to Chapter X, it is questionable whether the loss carry forward can be preserved.

FINDINGS OF FACT

1. I find, as a fact, that the debtor has formulated and filed a Plan of Arrangement and has solicited Acceptances and Consents to that plan. The solicitation was made pursuant to a combined Registration Statement on Form S-1 under the Securities Act of 1933 and Proxy Statement under the Securities Exchange Act of 1934. The Registration Statement containing the soliciting materials was filed with the Securities and Exchange Commission (the "Commission") on September 29, 1975, was processed by the Commission's staff and was declared effective by the Commission on March 19, 1976. So far as appears from the record herein the Proxy Statement included within the Registration Statement contained a full and fair disclosure of all material facts required to be made known to the holders of the debtor's public debt in connection with the solicitation of their Acceptances and Consents.

2. I find, as a fact, that at all times the Commission was fully aware that the debtor might seek to implement its Plan of Arrangement by a proceeding under Chapter XI of the Bankruptcy Act. If, at the time it completed its processing of the Debtor's Registration Statement on March 19, 1976, the Commission had concluded that a proceeding under Chapter XI would not be adequate, and if it had notified the debtor that it intended to bring instant motion in the event that the debtor proceeded under Chapter XI, the debtor would have been obligated to disclose that fact in its soliciting materials. No such communication was made until after the solicitation was substantially complete.

3. I find, as a fact, that the Plan of Arrangement provides for an exchange of debentures and preferred stocks for the presently outstanding publicly held subordinated debentures of the debtor. In view of the total

amount of the outstanding debentures and the total amount of senior bank debt, it is unlikely that any arrangement or reorganization could be accomplished without materially modifying the publicly held indebtedness. The terms of the securities to be issued in exchange for the publicly held indebtedness were negotiated by experienced businessmen representing financial institutions owning a substantial portion of the outstanding debt.

4. I find, as a fact, that the terms have been *accepted* by the holders of more than eighty per cent in principal amount of the publicly held debt. The Plan provides for significant payments to be made to the holders of the public debt before the senior bank debt is paid in full, which could not be done under the existing terms. It also gives the holders of the public debt the right to elect a majority of the Board of Directors of the debtor.

5. I find, as a fact, no evidence in the record on which to base a finding that terms more favorable to the public debtholders could have been negotiated. The terms of the securities to be issued in exchange for the publicly held debt appear to be fair to the holders thereof.

6. I find, as a fact, that the Commissions' instant motion was filed on June 18, 1976.

7. I find, as a fact, that the Court held a hearing, as previously scheduled, June 22, 1976, on the *confirmation* of the Plan of Arrangement, but the order thereon has not been entered pending the disposition of the present motion by the Commission.

8. I find, as a fact, that on the basis of the evidence adduced at that hearing, the Plan of Arrangement is *feasible* and in the *best interests* of the creditors.

9. I find, as a fact, that the Court held a hearing, August 3, 1976, on the present motion. The Commission

appeared by counsel and submitted in support of its motion affidavits and certain documentary material. The debtor submitted affidavits and additional documentary material. The official Creditors' Committee submitted an affidavit of its Chairman. The documentary material was admitted into the record by agreement.

10. I find, as a fact, that the arrangement and its acceptance are in *good faith* and have not been made or procured by any means, promises or acts forbidden by the Bankrutcy Act. There is no evidence of wrongdoing on the part of the management of the debtor. There is insufficient evidence in the record to warrant a finding that new management of the debtor is needed.

11. I find, as a fact, that there is insufficient evidence in the record to warrant a finding that a further investigation of the affairs of the debtor by an independent trustee would be either useful or productive.

12. I find, as a fact, that there is no need, in the event the Plan of Arrangement is confirmed, to take any action affecting the rights of secured creditors or holders of certificates of beneficial interest, other than implementation of the Omnibus Refinancing Agreement with the banks, which will require no further action by the Court.

13. I find, as a fact, that there is insufficient evidence in the record to warrant a finding that relief under Chapter XI of the Bankruptcy Act would not be adequate.

CONCLUSIONS OF LAW

The determination of a Motion by the Securities and Exchange Commission under Section 328 of the Bankruptcy Act (11 U.S.C. Sec. 728) and Rule 11-15 of the Rules of Bankruptcy Procedure, to have a case filed under Chapter XI of the Bankruptcy Act proceed under

Chapter X of the Bankruptcy Act is addressed to the sound discretion of the Bankruptcy Court exercised on the basis of the facts and circumstances of the case in question.

In the first decision of the United States Supreme Court resolving a problem of jurisdictional conflict between the reorganization of a corporation under Chapter X and rehabilitation under Chapter XI, the Court stated:

> "In this situation, we think the court was as free to determine whether the relief afforded by Chapter XI was adequate as it would have been if respondent had filed its petition under Chapter X. What the court can decide under Section 146 of Chapter X as to the adequacy of the relief afforded by Chapter XI, it can decide in the exercise of its equity powers under Chapter XI for the purpose of safeguarding the public and private interests involved and protecting its own jurisdiction from misuse." SEC v. United States Realty and Improvement Co., 310 U.S. 434, 456 60 S.Ct. 1044, 1053 (1940)

In General Stores Corp. v. Shlensky, 350 U.S. 462, 76 S.Ct. 516, (1956) the Court rejected the positions taken by the Securities and Exchange Commission that Chapter X affords relief for corporations with publicly held securities while Chapter XI is available to those whose stock is closely held. At page 466, the Court stated:

> "The character of the debtor is not the controlling consideration in a choice between C.X and C.XI. Nor is the nature of the capital structure. It may well be that in most cases where the debtor's securities are publicly held C.X will afford the more appropriate remedy. But that is not necessarily so. The essential difference is not between the small company and the large company but between the needs to be served."

In In the Matter of Wilcox-Gay Corp., 133 F. Supp. 548 (W.D. Mich. 1955), the district court denied the application of the Securities and Exchange Commission to transfer the Chapter XI proceeding to Chapter X, and the court of appeals unanimously affirmed this decision, SEC v. Wilcox-Gay Corp., 231 F. 2d 859 (6th Dir. 1956). The appellate court stated that it had withheld its decision until the Supreme Court had rendered its opinion in the General Stores v. Shlensky case. Its conclusions from the Court's analysis were that the discretion of the district court which had relied upon the case In the Matter of Transission, Inc., 217 F. 2d 243 (2d Cir. 1954), cert. denied, 348 U.S. 952 (1955), was a sound exercise of discretion.

The basis of such discretions was rooted in the following factors: a feasible plan; a reasonable likelihood of rehabilitation of the debtor; a benefit to stockholders only in the event that operations were profitable; adoption of the creditors' assertion that existing management was necessary for the continuation of the business; an opportunity open at all times for interested parties to call any irregularities to the attention of the court; the probability that a transfer to Chapter X might be prejudicial to the ultimate success of the plan; the fact that there was no public interest as distinguished from public ownership which required the intervention of the Commission; and, finally, the fact that further investigation was unnecessary in view of the active participation of the various interests involved, including a creditors' committee. SEC v. Wilcox-Gay Corp., 231 F. 2d 859, 860-861.

The undersigned bankruptcy judge has found that the holders of the publicly held debt were represented by a Debentureholders Protective Committee and that the Chapter XI Plan of Arrangement has been accepted by the holders of more than eighty per cent in the

principal of such debt. Sec. 362(1) of the Bankruptcy Act.

The undersigned bankruptcy judge has found that under Section 366 of the Bankruptcy Act (1) the provisions of Chapter XI have been complied with; (2) that the plan is for the best interests of the creditors and is feasible; (3) that the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and, (4) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises or acts forbidden by this Act.

An order confirming the Plan of Arrangement by the Bankruptcy Court has been withheld pending the final disposition of the present motion of the Securities and Exchange Commission.

The burden of establishing that adequate relief may not be obtained under Chapter XI is on the Securities and Exchange Commission, as moving party, and it has not sustained the burden.

In view of the very substantial investment of effort and expense which the debtor and others have made in formulating and implementing the Plan of Arrangement under Chapter XI of the Bankruptcy Act, the acceptance by over 80 per cent of the debenture holders to the Plan of Arrangement, the tax and practical advantages of proceeding under Chapter XI, the commitments made by the debtor and its creditors in reasonable anticipation of consummation of the Plan of Arrangement, the conduct of the Securities and Exchange Commission in failing to make objection at an earlier point, and relief under Chapter XI being adequate, this case should continue to proceed to confirmation under Chapter XI of the Bankruptcy Act, the undersigned bankruptcy judge having found that the Plan of Arrangement is in the best interests of the creditors and is feasible and meets the other requirements of Chapter XI of the Bankruptcy Act.

UNITED STATES OF AMERICA
IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

No. 76-1158-G

In the matter of
CONTINENTAL INVESTMENT CORPORATION
Debtor

In Proceedings for an Arrangement under Chapter XI

ORDER

At Boston, Massachusetts, in said District, this 9th day of November, 1976, for the reasons set forth in the foregoing Findings of Fact and Conclusions of Law,

IT IS ORDERED, ADJUDGED AND DECREED after hearings at which interested parties were represented, as follows:

That the Motion By The Securities And Exchange Commission To Have This Case Proceed Under Chapter X Of The Bankruptcy Act is denied.

/s/ Paul W. Glennon
PAUL W. GLENNON
Bankruptcy Judge

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APPENDIX D

Section 141 of the Bankruptcy Act, 11 U.S.C. § 541, provides:

> "Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied."

Section 146 of the Bankruptcy Act, 11 U.S.C. § 546, provides:

> "Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—
>
> "(1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or
>
> "(2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter XI of this Act; or
>
> "(3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> "(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

Section 328 of the Bankruptcy Act, 11 U.S.C. § 728, provides:

> "The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other per-

sons as the judge may direct, if he finds that the proceedings should have been brought under chapter X of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirements of chapter X for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with section 132 of this Act, such amended petition or creditors' petition shall thereafter, for all purposes of chapter X of this Act, be deemed to have been originally filed under such chapter."

APPENDIX E

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

No. 73-1158-G

In re
CONTINENTAL INVESTMENT CORPORATION,
Debtor

In Proceedings for an Arrangement Under Chapter XI

ORDER CONFIRMING PLAN

The debtor's proposed plan, filed on April 30, 1976, having been transmitted to creditors; and

The deposit required by Chapter XI of the Bankruptcy Act having been made; and

It having been determined after hearing on notice:

1. That the plan has been accepted in writing by the creditors whose acceptance is required by law; and

2. That the plan has been proposed and its acceptance procured in good faith, and not by any means, promises, or acts forbidden by law, that the provisions of Chapter XI of the Act have been complied with, that the plan is for the best interests of the creditors and is feasible,

and that the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt;

It is ordered that:

A. The debtor's plan filed on April 30, 1976, a copy of which is attached hereto, is confirmed.

B. Except as otherwise provided or permitted by the plan or this order:

(1) The debtor is released from all dischargeable debts;

(2) Any judgment heretofore or hereafter obtained in any court other than this court is null and void as a determination of the personal liability of the debtor with respect to any of the following:

(a) debts dischargeable under § 17a and b of the Act;

(b) unless heretofore or hereafter determined by order of this court to be nondischargeable, debts alleged to be excepted from discharge under clauses (2) and (4) of § 17a of the Act;

(c) unless heretofore or hereafter determined by order of this court to be nondischargeable, debts alleged to be excepted from discharge under clause (8) of § 17a of the Act, except those debts on which there was an action pending on April 30, 1976, the date when the first petition was filed initiating a case under the Bankruptcy Act, in which a right to jury trial existed and a party has either made a timely demand therefor or has submitted to this court a signed statement of intention to make such a demand;

(d) debts determined by this court to be discharged under § 17c(3) of the Act.

C. All creditors whose debts are discharged by this order and all creditors having claims of a type referred to in paragraph (B)(2) above are enjoined from instituting or continuing any action or employing any process to collect such debts as personal liabilities of the above-named debtor.

D. The securities to be distributed to creditors holding Class 3 claims pursuant to the plan are hereby valued, solely for the purpose of computing the payment to the salary and expense fund required under Section 40c(2) of the Bankruptcy Act, at $223.54 per $1,000 of Class 3 claims proved and allowed.

E. This court has previously denied a motion of the Securities and Exchange Commission to have this case transferred to Chapter X of the Bankruptcy Act. Nothing in this order shall moot or impair the right of the Securities and Exchange Commission to appeal from the order denying its transfer motion, and this order shall not be considered a final order for purposes of Article VI of the plan until any appeal by the Securities and Exchange Commission from the order denying the transfer motion, as well as any appeal from this order, have been finally determined. No consideration shall be distributed to creditors, and no other action shall be taken, under the plan until after final disposition of any appeal by the Securities and Exchange Commission from the order denying the transfer motion, as well as any appeal from this order. This court retains jurisdiction pursuant to Sections 368, 369 and 387 of the Bankruptcy Act, and to Article V of the plan, to consider revocation or modification of the plan and of this order if any such appeal from the order denying the transfer motion or from this order is successful.

Dated: November 30, 1976

/s/ Paul W. Glennon
PAUL W. GLENNON,
Bankruptcy Judge

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

Bankruptcy No. 76-1158

In re

CONTINENTAL INVESTMENT CORPORATION
Debtor

PROPOSED ARRANGEMENT

Continental Investment Corporation, a Massachusetts corporation ("CIC"), proposes the following Arrangement (the "Arrangement") with certain of its unsecured creditors.

I. ADMINISTRATION EXPENSES AND PRIORITY CLAIMS.

All claims for costs and expenses of administration, and all other claims of creditors entitled to priority under Section 64a of the Bankrupty Act, as filed and allowed, shall be paid in full, in cash, within 30 days after the Closing Date, as hereinafter defined, or after allowance of such claims, whichever shall be later, or in accordance with such terms as may be agreed upon by CIC and the creditors holding such claims.

II. DIVISION OF GENERAL CREDITORS INTO CLASSES.

Claims of general creditors shall consist of three classes. as follows:

Class 1. All claims of trade creditors (not including directors, officers or employees of CIC or of any subsidiary or affiliate of CIC) for merchandise sold or services rendered to CIC in the ordinary course of business of such trade creditor and CIC.

Class 2. (a) Any indebtedness of CIC to certain banks and the Federal Deposit Insurance Corporation (the "Banks") under (i) the 1973 Refunding Loan Agreement dated as of February 28, 1974, as amended, (ii) the Credit Agreement dated as of September 3, 1974, as amended, (iii) the Short Term Refunding Agreement dated as of December 5, 1974, and (iv) the Reorganization Credit Agreement dated as of October 3, 1975, each among CIC and The First National Bank of Boston, as Agent, and one or more of the Banks, and any related fees and payments.

(b) Any indebtedness of CIC to Diversified Advisers, Inc. ("DAI") as described in an agreement dated February 11, 1976 between CIC and DAI (the "DAI Agreement").

Class 3. All other unsecured claims of whatever character, including without limitation, claims with respect to CIC's presently outstanding 9% Convertible Subordinated Debentures due 1990 and 9% Subordinated Debentures due 1985.

III. PROVISIONS FOR THE ALTERATION AND MODIFICATION OF RIGHTS OF CREDITORS.

Class 1. Claims within this Class shall not be affected by the Arrangement, and such claims shall be paid by CIC in accordance with the respective terms thereof, or in accordance with such other terms as may be agreed upon by CIC and the creditors holding such claims.

Class 2. Claims within this Class shall not be affected by the Arrangement, and shall be disposed of (a) in the case of claims held by the Banks, by agreement between CIC and the Banks pursuant to the Omnibus Refinancing Agreement among CIC, the Banks and the Agent dated as of January 12, 1976 (the "Omnibus Refinancing Agreement"), and (b) in the case of claims held by DAI, in accordance with the DAI Agreement.

Class 3. Claims within this Class in an aggregate amount not exceeding $50,630,482 shall be paid, within 30 days after the Closing Date, as hereinafter defined, or after allowance of the claim, whichever is later, by the issuance, in full settlement and satisfaction thereof, of securities of CIC as hereinafter provided. Assuming claims within this Class aggregate $45,630,482, securities will be issued at the following rate per $100 of claim:

(a) $7.670308 in amount of CIC's Subordinated Interest-Inclusive Debentures due 1984, plus (b) 2.4654562 shares of CIC's Junior Preferred Stock with warrants attached at the rate indicated below, plus (c) 1.7532133 shares of CIC's Convertible Preferred Stock, with the amounts of Interest-Inclusive Debentures and the shares of Convertible Preferred Stock and Junior Preferred Stock to be rounded to the nearest whole dollar and share.

The maximum amounts of securities issuable to holders of Claims in Class 3 are as follows, before any adjustments for rounding to eliminate fractions of dollars and shares:

$3.5 million of Interest-Inclusive Debentures

1,260,000 shares of Junior Preferred Stock with warrants attached to purchase 1,993,575 shares of Common Stock

896,000 shares of Convertible Preferred Stock.

In the event that allowed claims in Class 3 exceed $45,630,482, with the result that insufficient Interest-Inclusive Debentures are available within the $3.5 million limit, the formula stated above shall be adjusted so that $3.5 million of Interest-Inclusive Debentures shall be distributed pro-rata among holders of allowed Class 3 claims and any decrease in the amount so distributed per $100 of claims shall be compensated for by an increase in the shares of Junior Preferred Stock with warrants attached and Convertible Preferred Stock so distributed, with the amount of increase measured by the $20 liquidation preference of the shares of each class, and with the class distributed in the same ratio as is provided in (b) and (c) above, all subject to adjustment to eliminate fractions of dollars and shares. If allowed claims in Class 3 exceed $50,630,482, modification of the Arrangement will be required prior to confirmation. Any such modification will be subject to the approval of the Bankruptcy Court. Certain provisions applicable to the Interest-Inclusive Debentures, the Convertible Preferred Stock and the Junior Preferred Stock are stated in the related Debenture Indenture between CIC and Bradford Trust Company as Trustee dated as of , 1976 and in CIC's Restated Articles of Organization.

IV. EXECUTORY CONTRACTS.

CIC reserves the right to apply to the Bankruptcy Court, prior to confirmation of this Arrangement or any modification thereof, to reject any and all contracts which are executory in whole or in part, as provided in Section 313(1) of the Bankruptcy Act, except that CIC shall not reject the Omnibus Refinancing Agreement or the related Pledge Agreement.

V. RETENTION OF JURISDICTION.

The Bankruptcy Court shall retain jurisdiction of this case, pursuant to the provisions of Sections 368 and 369

of the Bankruptcy Act, until the final allowance or disallowance of all duly filed claims affected by this Arrangement or any modification thereof, in respect to the following:

A. To enable CIC to consummate any and all proceedings which it may bring to set aside liens or encumbrances, or to recover any preferences, transfers, assets or damages to which they may be entitled under applicable provisions of the Bankruptcy Act or other federal, state or local law;

B. To enable CIC to consummate any and all proceedings which it may bring to reject executory contracts, including leases;

C. To hear and determine all claims arising from the rejection of any executory contracts, including leases;

D. To liquidate damages in connection with claims arising from the rejection of executory contracts, including leases, or in connection with any other contingent or unliquidated claims;

E. To adjudicate all claims to a security interest in any property of CIC or in any proceeds thereof;

F. To adjudicate all claims or controversies arising out of any purchases, sales or contracts made or undertaken by CIC during the pendency of this Chapter XI case;

G. To recover all assets and properties of CIC, wherever located;

H. To authorize CIC to borrow money and to issue certificates of indebtedness therefor upon such terms and having such priority as the Bankruptcy Court may determine; and

I. To accomplish any other purpose for which relief may be granted under the provisions of the Bankruptcy Act.

The Bankruptcy Court shall also retain jurisdiction of this case pursuant to the provisions of Section 368 of the Bankruptcy Act for the purposes set forth in Section 387 of the Bankruptcy Act and Rule 11-40 of the Rules of Bankruptcy Procedure, and in Section 377 of the Bankruptcy Act and Rule 11-42 of the Rules of Bankruptcy Procedure; *provided, however*, that if a closing has been held under the Omnibus Refinancing Agreement on or before the Closing Date, as contemplated by Article VII hereof, no modification or alteration of this Arrangement shall be made or requested which would affect the rights of the holders of the Refinancing Securities or the Senior Income Debentures, each as defined in the Omnibus Refinancing Agreement. Failure to hold a closing under the Omnibus Refinancing Agreement on or before the Closing Date, as contemplated by Article VII hereof, shall constitute a default under the terms of this Arrangement. Upon the occurrence of such default the Bankruptcy Court shall retain jurisdiction to enable CIC to propose a post-confirmation modification of the Arrangement, to dismiss the Arrangement proceeding, to transfer the case to a case under Chapter X of the Bankruptcy Act as provided in Section 328 of the Bankruptcy Act and Rule 11-15 of the Rules of Bankruptcy Procedure, or to adjudicate CIC a bankrupt and direct that bankruptcy be proceeded with.

VI. CONFIRMATION AND CLOSING DATES.

For purposes of this Arrangement: The "Confirmation Date" shall be the date on which a final judicial order shall have been entered confirming the Arrangement and all applicable appeal periods shall have expired without the filing of an appeal, or, if an appeal

shall have been filed such appeal shall have been dismissed (or such order shall have been affirmed) and all applicable periods for the filing of further appeals shall have expired. The "Closing Date" shall be the third business day after the Confirmation Date.

VII. OTHER APPROPRIATE PROVISIONS NOT INCONSISTENT WITH CHAPTER XI.

A closing is to be held by CIC and the Banks on or before the Closing Date, pursuant to Section 3 of the Omnibus Refinancing Agreement. Consummation of the Arrangement, including payment of claims in Class 3 as provided in Article III hereof, and the discharge of CIC, are contingent upon the consummation of such closing.

Boston, Massachusetts

April 30, 1976

CONTINENTAL INVESTMENT CORPORATION

By _____

Its Attorney, CHARLES P. NORMANDIN
Ropes & Gray
225 Franklin Street
Boston, Massachusetts 02110
617-423-6100

APPENDIX F

APPENDIX A

Summary of some recent Chapter XI proceedings in which major adjustments of publicly held debt were effectuated.*

1. *NATIONAL MORTGAGE FUND (N.D. Ohio #B-76-1150). Chapter XI petition filed 6/30/76, plan confirmed 12/14/76.*

Publicly held debt consisted of 8½% Senior Subordinated Notes, 7% Subordinated Convertible Notes, and 7% Subordinated Convertible Debentures totalling (with interest) $8.8 million and held by 1,540 holders. The plan offered two options for these holders: (a) 10% in cash plus 50% in shares of beneficial interest (the equivalent of common stock) at $2.50 a share (shares traded in April between ¼ and ⅜); or (b) 5% in cash plus 30% in shares of beneficial interest at $2.50 per share, plus 65% in new noninterest-bearing subordinated notes due in 8, 9 and 10 years respectively (depending upon which category of debt was previously held). Acceptances were solicited prior to filing of the Chapter XI petition pursuant to a proxy statement filed with the Commission under its proxy rules. The Commission did not file a transfer motion, and such a motion filed by private parties was denied.

* This Appendix has been largely prepared from certified court records but also includes information obtained from proxy statements and discussions with counsel involved.

2. *CAVANAGH COMMUNITIES CORPORATION (S.D.N.Y. #75-B-243). Chapter XI petition filed 2/8/75, plan confirmed 12/13/76.*

Publicly held debt consisted of $8.1 million of 9% Convertible Subordinated Debentures held by about 1,500 holders. Under the plan, each $1,000 principal amount of Debentures (unpaid interest to be waived) is to be exchanged for either (a) $40 plus 10 shares of $1 par value Convertible Preferred Stock (carrying the right to additional cash distributions in the succeeding four years of $8, $8, $3 and $3 per share), or (b) a $1,000 9% Revised Subordinated Debenture maturing in 1991, with interest payable until 1985 in cash or in common stock, at the debtor's option, and payable in cash thereafter. The Commission several times gained extensions of time for filing a transfer motion, but never did so.

3. *DAYLIN, INC. (C.D. Cal., #BK 75-02958 JM). Chapter XI petition filed 2/26/75, plan confirmed 10/20/76.*

Publicly held debt included $28.3 million principal amount of 5% Debentures with 3,200 holders. The plan provided that these would be satisfied with (1) noninterest-bearing short-term (3 year class B) Notes in the aggregate principal amount of $2.46 million plus (2) subordinated long-term (23-year class B) Debentures in the aggregate principal amount of $930,00-, carrying 8% interest after five years, plus (3) shares of common stock equal to about 33% of the total common stock for the balance. The solicitation was made through a combined proxy statement/registration statement. In the Chapter XI proceedings the Commission filed for extensions of the time permitted for its motion to transfer totalling at least half a year, but in the end the Commission never moved to transfer the proceedings to Chapter X.

4. *ESGRO, INC. (C.D. Cal. #73-02510). Chapter XI petition filed 3/13/73; plan confirmed 5/18/76.*

Publicly held debt consisted of $6 million in 6% Convertible Subordinated Debentures held by 560 persons of record, but the actual number of beneficial owners was at least 675. This was satisfied as follows: (1) 10% cash, plus (2) an additional 10% in cash during and within a year, plus (3) $1 million (spread evenly among all general unsecured creditors, including about $4 million due to trade creditors, thus amounting to about another 10%) in 7% four-year subordinated notes, plus (4) about 480,000 shares class A no par stock (actually 800,000 shares for the total $10 million general unsecured debt). The Commission filed a transfer motion which was denied by the Bankruptcy Court, which found, among other things, that the plan materially modified the terms of the publicly held debentures. The Commission appealed, but later withdrew the appeal with prejudice.

5. *SHERWOOD DIVERSIFIED SERVICES, INC. (S.D.N.Y. #73-B-213). Chapter XI Petition filed 3/2/73; plan confirmed 4/12/76.*

There were two outstanding categories of publicly held debt: (1) 6⅝% Convertible Subordinated Debentures, totalling $9.68 million and held by 1,816 holders and (2) 6% Convertible Subordinated Debentures totalling $3.89 million and held by 666 holders. Under the plan, holders of the 6⅝% debentures received 40 shares of New Common Stock per $1,000 principal amount; holders of the 6% debentures would receive 20 such shares. These were projected to constitute about 69% and 13% of post-confirmation outstanding stock, respectively. There was no transfer motion.

6. *ASSOCIATED MORTGAGE INVESTORS (S.D. N.Y. #74-B-312). Chapter XI Petition filed 3/15/74; plan confirmed 9/9/75.*

Publicly held debt consisted of $10 million principal amount of 10% Senior Subordinated Debentures which had been due 12/15/73 as to which debtor had defaulted. This was satisfied with cash payments of $500,000 upon confirmation, $1 million on each June 1 of 1976, 1977 and 1978, and $2⅓ million on each of 12/1/78, 4/15/79, and 12/1/79, plus 300,000 shares of beneficial interest. The Commission gained over a year of extensions for filing a transfer motion, but such a motion was never filed.

7. *SHEFFIELD WATCH CORPORATION (S.D.N.Y. 71-B-544). Involuntary petition in bankruptcy filed 6/2/71; Chapter XI petition filed by debtor 6/3b/72; plan confirmed 8/21/74.*

Publicly held debt included 7¼% Convertible Subordinated Debenture Bonds amounting to $2.48 million held by approximately 335 holders. Under the plan, these holders received 6% in cash. There was a complicated side agreement, disclosed to the court but not part of the plan, under which another 10% or so was disbursed to the debenture holders. (This complication arose from the myriad of claims involving ten subsidiaries, which claims were pooled.) There was no transfer motion by the Commission.

8. *HORN & HARDART (E.D. Pa. #71-752).*

(Detailed information not obtained).

9. *FAS INTERNATIONAL, INC. (S.D.N.Y. #72-B-128). Chapter XI petition filed 2/8/72; plan confirmed 8/2/73.*

Publicly held debt included $16.3 million principal amount of 5% Convertible Subordinated Debentures held by approximately 550 persons. The debenture holders received 20% of the post-confirmation stock. The Commission did not file a transfer motion.

APPENDIX G

ROPES & GRAY
225 Franklin Street
Boston 02110

October 26, 1978

Dana H. Gallup, Clerk
United States Court of Appeals
for the First Circuit
Post Office and Courthouse Building
Boston, Massachusetts 02109

In re Continental Investment Corporation
Appeals Nos. 78-1204, 1205 and 1238

Dear Sir:

The appeals referred to above, which were argued on September 13, 1978, involve the issue of whether the debtor's reorganization should proceed under Chapter X or Chapter XI of the Bankruptcy Act. I wish to call the Court's attention to a development occurring since the appeals were briefed and argued which, I believe, may be of some significance and interest. I refer to the recent enactment by Congress of H.R. 8200, which represents a comprehensive revision and reform of the bankruptcy laws. The legislation has not yet been signed by President Carter, but his signature is anticipated in the immediate future.

Under the new legislation, reorganization of a financially distressed business, whether privately held or having publicly held debt or stock, will take place under a new, unified Chapter 11, which replaces Chapters X, XI and XII of the present Bankruptcy Act. Thus, a

dispute such as that involved in these appeals will not arise in the future. A copy of the new Chapter 11 is enclosed.

The new bankruptcy law will not become effective until October 1, 1979, and will apply only to cases initiated after that date. It is not, I recognize, directly applicable to the appeals involving Continental Investment Corporation's reorganization. But, in so far as those appeals involve questions of public policy, and the views of Congress with respect to corporate reorganization, the new legislation is of significance.

In particular, I would call the Court's attention to remarks by Congressman Edwards and Senator DeConcini, Chairmen of the House Subcommittee and Senate Committee having jurisdiction over the legislation, appearing at 124 Congressional Record pages H11,100-11,105 (September 28, 1978) and pages S.17,417-17,421 (October 6, 1978), a copy of which is enclosed.

I have enclosed extra copies of this letter which I would appreciate your transmitting to the Court.

Very truly yours,

/s/ Charles P. Normandin
CHARLES P. NORMANDIN

CPN/vbb
enclosures

cc: Counsel listed on attached page

No. 78-1168

In the Supreme Court of the United States

OCTOBER TERM, 1978

MONTE J. WALLACE AND NEIL W. WALLACE,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a, 19a-20a) is reported at 586 F.2d 241. The opinions of the district court (Pet. App. 1b-7b) and bankruptcy court (Pet. App. 1c-12c) are not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 17a-18a) was entered on October 27, 1978. The petition for a writ of certiorari was filed on January 25, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a corporate debtor proposing a major recapitalization involving adjustment of the rights of numerous public debentureholders must proceed under Chapter X rather than Chapter XI of the Bankruptcy Act.

STATUTE AND RULE INVOLVED

Relevant provisions of the Bankruptcy Act are set forth at Pet. App. 1d-2d. Rule 11-15 of the Rules of Bankruptcy Procedure is reproduced in the appendix to this brief.

STATEMENT

1. Petitioners own or control 65% of the common stock of respondent Continental Investment Corp. ("CIC") (A. 41, 301).[1] CIC is a holding company that provides diversified financial services through subsidiary corporations (Pet. App. 3a). In fiscal year 1973 CIC suffered serious financial losses (A. 283-287). As a result, CIC defaulted on loan obligations to 16 banks and failed to meet its interest obligations to subordinated public debentureholders (Pet. App. 3a). Following this default, CIC negotiated an agreement with its lending banks, certain debentureholder representatives, and petitioners. That agreement contemplated an overall, extra-judicial restructuring of the corporation's capitalization (A. 395-413). CIC and the banks then entered into an "omnibus refinancing agreement" to implement the restructuring of the company's bank debt (A. 53). Because new securities were to be issued and exchanged in connection with the recapitalization, CIC also filed with the Securities and Exchange Commission a statement needed to register the securities and to solicit proxies from stockholders and waivers and acceptances from debentureholders.[2] CIC stated that if acceptance of the securities to be exchanged in the recapitalization plan could not be obtained from the holders of 95% of the debentures, an arrangement proceeding under Chapter XI of the Bankruptcy Act would be commenced (A. 208).

Less than a week before CIC filed its registration and proxy statement with the Commission, representatives of CIC and other interested parties met with the Commission's reorganization staff and made an oral presentation concerning the planned recapi-

[1] "A." refers to the two-volume appendix filed in the court of appeals.

[2] See Section 5 of the Securities Act of 1933, 15 U.S.C. 77e; Section 14 of the Securities Exchange Act of 1934, 15 U.S.C. 78n; and SEC Rule 14a thereunder, 17 C.F.R. 240.14a-1 *et seq.* CIC's March 19, 1976, prospectus and proxy statement appear at A. 187-394.

talization (A. 523). They expressed the hope that CIC would not have to resort to the bankruptcy court and that a voluntary exchange of securities could be effected (*ibid.*). Failing that, they planned to file a petition under Chapter XI of the Bankruptcy Act (*ibid.*). While the Commission's staff did not state that the Commission would file a motion to transfer such a proceeding to Chapter X, the staff informed the parties of the principle enunciated by this Court in *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965), that corporate debtors could not achieve a major adjustment of debt held by public investors in a Chapter XI proceeding (A. 524). The staff also indicated that, while it was premature to consider the question of transfer to Chapter X, it would make its recommendation to the Commission based on whether the public interest would best be served by Chapter X proceedings in the circumstances of the case (A. 525). CIC's own proxy statement and prospectus show that it realized that the Commission might file such a transfer motion (A. 190, 214, 221, 268).

CIC failed to obtain the requisite number of acceptances from its debentureholders, and it filed a petition under Chapter XI to which was attached the earlier recapitalization proposal as a Chapter XI plan of arrangement (A. 1-6). CIC sought to use the acceptances it had obtained from approximately 82% of its debentureholders to obtain confirmation of its plan (Pet. App. 3a). CIC reported in its petition that it had outstanding secured loan obligations

in the amount of $31,288,000; two classes of unsecured debt securities held by more than 1,600 investors in the amount of $45,344,000;[3] miscellaneous liabilities totalling $3,648,000; and 12,944,533 shares of common stock held by 4,100 investors (Pet. App. 3b; A. 4-5).

CIC's plan of arrangement called for a complex restructuring of both issues of publicly-held debentures and a portion of the bank debt (Pet. App. 3b, 5b, 3c).[4] Had the proposed recapitalization been accomplished,[5] CIC would have emerged with a new capital structure consisting of eight layers of securities: Senior Term Notes, Senior Preferred Stock With Warrants Attached, Subordinated Interest-Inclusive Debentures, Junior Preferred Stock With Warrants Attached, Convertible Preferred Stock, and 13 million shares of Common Stock (Pet. App. 3a, 4a, 8a).

2. Pursuant to Section 328 of the Bankruptcy Act, 11 U.S.C. 728, and Rule 11-15(b) of the

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[3] These debt securities included $1,511,000 in 9% convertible subordinated debentures due 1990 and $37,158,900 in 9% subordinated debentures due 1985 (Pet. App. 3b). The accrued interest obligation on these securities was approximately $6,960,000 at the time the petition was filed.

[4] Under the omnibus refinancing agreement, the bank creditors previously had agreed to purchase a CIC subsidiary, thus reducing the bank indebtedness to $27,000,000 (Pet. App. 3b, 3c).

[5] Acceptance of the arrangement by a majority (in number and amount) of each creditor class would have resulted in confirmation and thus bound all members of the class. See Section 362 of Chapter XI, 11 U.S.C. 762.

Rules of Bankruptcy Procedure, the Commission filed a timely motion to transfer the case to Chapter X (Pet. App. 4a). The bankruptcy court denied the Commission's transfer motion, even though it found that "it is unlikely that any arrangement or reorganization could be accomplished without materially modifying [CIC's] publicly held indebtedness" (Pet. App. 6c). The district court reversed, holding that *SEC* v. *American Trailer Rentals Co., supra*, required the case to proceed under Chapter X because it did "not fall within the exceptions to the general rule that proceedings for adjustment of publicly held debt should appropriately be in Chapter X" (Pet. App. 7b).

The court of appeals affirmed the district court, pointing out that:

> [a]ll parties concede that the reorganization proposed in this case is major, greatly altering the rights of numerous widespread public investors. Therefore, this corporate rehabilitation, if it is to go forward at all, must proceed in Chapter X. It is the exact kind of case for which Congress intended Chapter X.

Pet. App. 8a; footnote omitted. The court of appeals observed that this Court's opinion in *America Trailer Rentals* "stated in no uncertain terms that major reorganizations of publicly held debt where the investors are many and widespread must proceed in Chapter X" (Pet. App. 16a, 20a).

ARGUMENT

The decision of the court of appeals, on which we generally rely, is in accordance with principles long established by this Court and does not conflict with any decision of another circuit. Review by this Court is unwarranted.

1. This Court has repeatedly pointed out that Chapters X and XI, added to the Bankruptcy Act in 1938, are designed to serve fundamentally different purposes.[6] The two chapters " 'were specifically devised to afford different procedures, the one [Chapter X] adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other [Chapter XI] to composition of debts of small individual businesses and corporations with few stockholders * * *.' " *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594, 608 (1965), quoting from *SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434, 447 (1940). Where major recapitalizations are required, Chapter X provides administrative safeguards essential to the protection of public investors:

> The aims of Chapter X * * * were to afford greater protection to creditors and stockholders

[6] The Bankruptcy Act has been greatly revised and recodified by Pub. L. No. 95-598, 92 Stat. 2549. Section 403(a) of the new Act provides that the old law applies to all cases commenced before October 1, 1979 (92 Stat. 2683). The new Act thus provides no support to petitioners; the enactment of a new code for bankruptcy cases suggests, to the contrary, that review by this Court of cases under the old statute is unnecessary. See page 12, *infra*.

> by providing greater judicial control over the entire proceedings and impartial and expert administrative assistance * * * through appointment of a disinterested trustee and the active participation of the SEC.

379 U.S. at 604. The trustee appointed under Chapter X must make a thorough examination of the debtor's financial condition, transmit his independent report to creditors and stockholders, and formulate a reorganization plan to be commented on by the Commission, approved by the district court, and voted on by all affected parties in interest. *Ibid.*

The contrast between the provisions of Chapter X and Chapter XI is marked. Under Chapter XI, formulation of the plan of arrangement rests primarily with the debtor. "There are no provisions for an independent study by the court or a trustee, or for advice by them being given to creditors in advance of the acceptance of the arrangement." *SEC* v. *American Trailer Rentals Co., supra,* 379 U.S. at 606. Chapter XI "sacrifices to speed and economy every safeguard, in the interest of thoroughness and disinterestedness, provided in Chapter X." *SEC* v. *United States Realty & Improvement Co., supra,* 310 U.S. at 450-451.

In light of the limited purpose of Chapter XI to "provide a quick and economical means of facilitating simple compositions among general creditors" (*SEC* v. *American Trailer Rentals Co., supra,* 379 U.S. at 606), this Court has emphasized that "as a general rule Chapter X is the appropriate proceeding for

adjustment of publicly held debt" (*id.* at 613).[7] Exceptions to this general rule are narrowly defined (*id.* at 614):

> *General Stores* [*Corp.* v. *Schlensky,* 350 U.S. 462 (1956)] indicates the narrow limits within which there are exceptions to this general rule that the rights of public investor creditors are to be adjusted only under Chapter X. "Simple" compositions are still to be effected under Chapter XI. Such a situation, even where public debt is directly affected may exist, for example, where the public investors are few in number and familiar with the operations of the debtor, or where, although the public investors are greater in number, the adjustment of their debt is relatively minor, consisting, for example, of a short extension of time for payment.

There is no dispute that the plan proposed in this case is not a simple composition. Thousands of public investors would be affected by a complex scheme of reorganization, totally revising the capital structure of the corporation (see Pet. App. 8a). As the Court said in *SEC* v. *American Trailer Rentals Co., supra,* 379 U.S. at 615:

> Here public debts are being adjusted. The investors are many and widespread, not few in number intimately connected with the debtor,

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[7] The Court noted in *American Trailer Rentals* (*ibid.*) that it was reaffirming the principle of *SEC* v. *Canandaigua Enterprises Corp.,* 339 F.2d 14 (2d Cir. 1964), which held that "the need for a readjustment of publicly held debt creates a presumption in favor of Chapter X * * *." 339 F.2d at 19.

and the adjustment is quite major and certainly not minor. These facts alone would require Chapter X proceedings under the above-stated principles.

In simple terms, the "needs to be served" in a proceeding of this nature require resort to the provisions of Chapter X. See *General Stores Corp.* v. *Shlensky*, 350 U.S. 462, 466 (1956); Pet. App. 8a-9a.[8]

Petitioners nonetheless contend (Pet. 9) that the expense and delay resulting from compliance with Chapter X must be considered. Although it observed that this Court has determined that such factors are not relevant where a complex recapitalization is undertaken (*SEC* v. *American Trailer Rentals Co.*, *supra*, 379 U.S. at 617-618), the court of appeals concluded that there is little danger of unnecessary delay and expense. Chapter X is "flexible," and if it is in fact consistent with the interests of public investors, the plan negotiated by CIC should receive "expedited" consideration (Pet. App. 16a). This finding is a sufficient answer to petitioners' argument.[9]

[8] It would be anomalous to permit the issuance of eight layers of new securities in a Chapter XI proceeding designed for "simple compositions." Even with the numerous procedural safeguards prescribed under Chapter X to assure that the plan is analyzed by an independent trustee and clearly presented to investors, "the substitution of a simple, conservative capital structure for a highly complicated one may be a primary requirement of any reorganization plan." *Consolidated Rock Products Co.* v. *Du Bois*, 312 U.S. 510, 531 (1941).

[9] Contrary to petitioners' assertion (Pet. 15), the Commission has not "usurped" the judiciary's role by moving for a transfer in this case. Under the Bankruptcy Act and rules thereunder, the Commission or any party in interest may move for a transfer. The decision whether to transfer is a judicial decision, guided by the principles enunciated by this Court. See *SEC* v. *American Trailer Rentals Co.*, *supra*, 379 U.S. at 619-620.

2. Contrary to the assertion of petitioners (Pet. 13-14), the decision below does not conflict with that of any other circuit. *In re Penn Central Transportation Co.*, No. 78-1715 (3d Cir. Jan. 11, 1979), approved a railroad reorganization under Section 77 of the Bankruptcy Act and an arrangement of the debt of the railroad's parent under Chapter XI. The debt arranged in the Chapter XI proceeding was not publicly held debt; the petition of the debtor disclosed that approximately 70 banks and financial institutions were the holders of the indebtedness. There was thus no need to protect debt holders under Chapter X. Moreover, while the proceeding under Section 77 was complex (slip op. 10), the proceeding under Chapter XI simply involved the exchange of debt securities for common stock. In these circumstances, expedited procedures were appropriate under Chapter XI.[10] Similarly, in *In re Alrac Corp.*, 550 F.2d 1314 (2d Cir. 1977), the Chapter XI plan provided for a relatively simple adjustment: "Full payment of the principal on Alrac notes and debentures has been

[10] The Third Circuit stated that proceedings under Chapter X would not be preferable in these circumstances, pointing out that "no absolute rule" governs whether rehabilitation should proceed under Chapter X (slip op. 22 n.10). The court of appeals here also recognized that there is no absolute rule (Pet. App. 6a-7a).

provided for and the adjustment affected only the timing of the payments and the note holders' right to interest after August 20, 1974." *Id.* at 1319. As the court of appeals here pointed out, the present reorganization "is far more pervasive than that in *Alrac*" (Pet. App. 13a).

3. In any event, the decision in the case is of little future importance. On November 6, 1978, Congress enacted a new Bankruptcy Act, Pub. L. No. 95-598, 92 Stat. 2549. The Act prescribes one consolidated business rehabilitation chapter in place of Chapters X and XI of the present Act. See 92 Stat. 2625. Thus, with respect to petitions filed after the effective date of the new statute (October 1, 1979), there will be no occasion for the lower courts to decide whether to transfer proceedings. There is no reason for this Court to review a case under the old statute.[11]

It is true that under Section 1104(a) of the new Act, 92 Stat. 2627, questions of interpretation will arise regarding the circumstances under which a reorganization trustee need be appointed. However, contrary to the assertion of petitioners (Pet. 18-19), those questions should be resolved in the future under the terms and policies of the new statute, and the holding of the court below should have no controlling effect.

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[11] As CIC's counsel stated in the court of appeals, the creation of a unified reorganization procedure means that "a dispute such as that involved in these appeals will not arise in the future" (Pet. App. 1g-2g).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MARCH 1979

APPENDIX

RULES OF BANKRUPTCY PROCEDURE

Rule 11-15

CONVERSION TO CHAPTER X

(a) Motion by Debtor. A debtor eligible for relief under Chapter X of the Act may, at any time, make a motion to have the case proceed under such Chapter.

(b) Motion by Party in Interest Other Than Debtor. At any time until 120 days after the first date set for the first meeting of creditors in the Chapter XI case, a motion may be made by the Securities and Exchange Commission or other party in interest to have the case proceed under Chapter X of the Act. The court may, for cause shown, extend the time for making such motion.

(c) Form of Motion; Answer. A motion made under this rule shall state why relief under Chapter XI of the Act would not be adequate and shall also conform substantially to Official Form No. 10-1. * * *

(d) Hearing and Order. After hearing, on notice to the debtor, the Securities and Exchange Commission, indenture trustees, creditors, and stockholders, and such other persons as the court may direct, the court shall, if it finds that the case may properly proceed under Chapter X of the Act, grant the motion and order that the case proceed under that Chapter. The granting of the motion shall be deemed to constitute approval of a petition under Chapter X.

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